United States Court of Appeals

for the Second Circuit

APPENDIX

75-6131

B

United States Court of Appeals

FOR THE SECOND CIRCUIT

NO. 75-6131

THE AETNA CASUALTY AND SURETY COMPANY,
Plaintiff-Appellant

vs.

UNITED STATES OF AMERICA,
Defendant-Appellee

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF CONNECTICUT

JOINT APPENDIX
THE AETNA CASUALTY AND SURETY COMPANY
AND
UNITED STATES OF AMERICA

WILLIAM G. DELANA
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Hartford, Connecticut 06103
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GEORGE G. WOLF
DEPARTMENT OF JUSTICE
Washington, D.C. 20530
Counsel for Defendant-Appellee

5

PAGINATION AS IN ORIGINAL COPY

LIST OF CONTENTS

RELEVANT DOCKET ENTRIES

August 14, 1973	Complaint, filed.
October 15, 1974	Stipulation of Facts, jointly filed by the parties.
December 4, 1974	Deposition of Stephen B. Middlebrook, filed. Deposition taken pursuant to notice given by the defendant.
February 3, 1975	Amended Answer, filed.
February 20, 1975	Defendant's Motion for Summary Judgment, filed.
February 21, 1975	Plaintiff's Motion for Summary Judgment, filed.
October 15, 1975	Memorandum of Decision, *The Aetna Casualty and Surety Company v. United States of America,* Civil No. H-131 (D. Conn., October 15, 1975). The plaintiff's Motion for Summary Judgment is denied, the defendant's Motion for Summary Judgment is granted. It is so ordered. Blumenfeld, J. M-10-15-75. Copies mailed.
December 10, 1975	Summary Judgment entered for the defendant and plaintiff's Complaint dismissed. Markowski, C. M-12-11-75. Copies mailed.

(right hand page)

CIVIL DOCKET

UNITED STATES DISTRICT COURT

D. C. Form No. 106 Rev.

H 131

Jury demand date:

placed on Trial List 10-19-73

MJ

TITLE OF CASE	ATTORNEYS
THE AETNA CASUALTY AND SURETY COMPANY, for itself and as successor by merger to the Aetna Casualty & Surety Company	For plaintiff: William G. DeLana Day, Berry & Howard One Constitution Plaza Hartford, Conn. 06103
VS	J. Danford Anthony Jr. Paul F. McAlenney Day Berry & Howard One Constitution Plaza Hartford, Conn. 06103
UNITED STATES OF AMERICA	
	For defendant: Henry S. Cohn 450 Main St. Hartford, Conn. 06103
	Jerome Fink tel. 202-739-3646 Robert M. Greco, Trial Atty Tax Division, Dept of Justice Washington, D.C. 20530

STATISTICAL RECORD	COSTS		DATE	NAME OR RECEIPT NO.	REC.	
J.S. 5 mailed	Clerk		1973 8/14	Day, Berry & Howard	15.00	
			8/17	Deposit (G.F.100869)		15
J.S. 6 mailed	Marshal					
Basis of Action: Action is instituted pursuant to 28 USC, under	Docket fee					
Internal Revenue laws; seeks	Witness fees					

-4-

H 131

DATE 1973	PROCEEDINGS
8/14	1. Complaint , filed. Summons issued and together with same and copies of complaint handed to Marshal for service.
8/20	2. Marshal's return showing service upon U.S. Atty and receipt for certified mail for complaint & summons mailed to Atty General Wash. D.C.
10-15	3. ANSWER filed.
10-19	PLEADINGS CLOSED letter mailed to counsel of record.
11-21	4. APPEARANCE of J. P. Anthony & P. [illegible] entered for Pltf.
11-27	5. Pretrial Memorandum for the Defendant filed.
12-3	6. PRETRIAL ORDER filed. Blumenfeld, J. m 12-4-73 Copies mailed to counsel of record.
6-14	7. Notice of Deposition filed by Def. (Re: Stephen Millbrook)
8-30	8. Stipulation filed that defendant's time for filing stipulation of facts and written report to the Court is extended until Oct. 15, 1974. Ordered accordingly (Markowski, C.) 9-9-3 Copies mailed to counsel.
10-8	9. Notice of Deposition by def.
10-15	10. Joint Report on Further Proceedings Required filed by def. & Pltf.
"	11. Stipulation of Facts filed.
12-4	12. Deposition of Stephen B. Middlebrook filed.
12-12	13. Motion to Amend Briefing Schedule, , Granted. Blumenfeld, J. m 12-13. Copies mailed to counsel.
1975	
2-3	14. Motion to File an amended answer. Ordered accordingly, Markowski, Copies [illegible]
"	15. Amended Answer filed.
2-5	16. Letter RE: filing of brief until 3/21/75. Request granted. A. Latimer m 2/5/75 N.H.). Copies mailed to counsel.
2-20	17. Def. Motion for Summary Judgment.
"	18. Brief for the Defendant in Support of Its Motion for Summary Judgment.
2-21	19. Plaintiff's Motion for Summary Judgment.
"	20. Brief for the Plaintiff in Support of Its Motion for Summary Judgment.
3-24	21. Reply Brief for the Defendant in Opposition to Pltf. Motion for Summary Judgment.
"	Hearing over to 4/28/75
"	22. Reply Brief for the Pltf. in Response to the Brief for the Def. in Support of Its Motion for Summary Judgment.
4-23	23. Response for the Plaintiff to Part II of the Reply Brief of the Def. in Opposition to Plaintiff's Motion for Summary Judgment.
4-24	24. Appearance of Robert M. Greco entered for the Defendant.
4-25	25. Response for the Plaintiff to Part II of the Reply Brief of the Def. in Opposition to Plaintiff's Motion for Summary Judgment.
4-28	HEARING on Def. and Pltf. motions for summary judgment. D.C. reserved.
7/25	Court Reporter's Notes of Proceedings held on April 28, 1975 filed in Hartford. (Collard, R.)
10-15	26. Memorandum of Decision , Blumenfeld, J. m 10-15-75. Copies mailed to counsel of record.
12-10	27. JUDGMENT entered. Markowski, C. m 12-11-75, Copies mailed.
12-12	28 . Notice of Appeal filed. Certified copies of notice and of copies of docket entries mailed to US. Court of Appeals and New Haven. Copy of Civil Management Plan and Forms C & D mailed to Pltf. Atty. Bond for Costs filed with appeal. Copies of notices mailed to counsel of record.

A True Copy
Attest:

[illegible]
[illegible] District Court

By: A. M. Greco
Deputy Clerk

FILED

AUG 14 10 21 AM '73

CLERK
U.S. DISTRICT COURT
HARTFORD, CONN.

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

THE AETNA CASUALTY AND SURETY COMPANY, for itself and as successor by merger to The Aetna Casualty and Surety Company, Plaintiff,	:	
V.	:	Civil Action No. 11 131
UNITED STATES OF AMERICA, Defendant.	:	

COMPLAINT

1. This action is instituted pursuant to 28 U.S.C. § 1346(a), and arises under the Internal Revenue laws of the United States as hereafter more fully appears.

2. The plaintiff is an insurance company incorporated under the laws of Connecticut engaged in the business of writing and selling liability, fire, theft, property damage, and surety insurance, with its principal place of business at 151 Farmington Avenue, Hartford, Connecticut, and is the successor by statutory merger, effected December 29, 1964, to its predecessor corporation, The Aetna Casualty and Surety Company (hereinafter referred to as "Old Aetna"), which was also an insurance company incorporated under the laws of Connecticut engaged in the business of writing and selling liability, fire, theft, property damage, and surety insurance, with its principal place of business at said address.

3. The plaintiff seeks recovery of $4,071,655.21 in Federal income taxes paid to the defendant, United States of America, in respect of the taxable year 1963, plus deficiency interest paid thereon of $395,975.38.

4. Prior to December 29, 1964, Aetna Life Insurance Company ("Aetna Life") owned 4,312,536, or 61.6 percent, of the 7,000,000 outstanding shares of common stock of Old Aetna. Pursuant to a plan of reorganization, Aetna Life organized the plaintiff (under the name of Farmington Valley Insurance Company) and, on December 29, 1964, issued 13,300,000 shares of its stock to the plaintiff in exchange for all (1,000 shares) of the plaintiff's newly issued stock. Old Aetna was then merged into the plaintiff pursuant to Connecticut law, with 1.9 shares of the common stock of Aetna Life being distributed to the shareholders of Old Aetna in exchange for each share of Old Aetna stock owned by them. On December 29, 1964, the plaintiff changed its name from Farmington Valley Insurance Company to The Aetna Casualty and Surety Company.

5. The merger of Old Aetna into the plaintiff constituted a mere change in identify, form, or place of organization within the meaning of Section 368(a)(1)(F) of the Internal Revenue Code.

6. Alternatively, Old Aetna and the plaintiff were one and the same corporation and the reorganization constituted nothing more than an acquisition by Aetna Life of the Old Aetna stock held by its minority stockholders.

7. Pursuant to an audit of the Federal income tax returns filed by Old Aetna and the plaintiff, and to Internal Revenue Forms 872 extending the period of limitations upon the assessment of additional taxes for all years involved until December 31, 1971, the plaintiff and the defendant executed Internal Revenue Forms 870-AD in 1971 with respect to the Federal income tax liability of such corporations for the taxable years 1959; 1960; 1961; 1962; 1963; January 1 through December 29, 1964; December 30 through December 31, 1964; and 1965. Such Forms 870-AD specifically reserved to the plaintiff the right to pursue the claims for refund that are the subject of this action.

8. Pursuant to said Forms 870-AD it was determined that the taxable income of Old Aetna for the taxable year 1962, before giving effect to net operating loss carrybacks from subsequent years but after giving effect to net operating loss carryovers from prior years, was $2,052,316.50. It was determined that the taxable income of Old Aetna for the taxable year 1963, before giving effect to net operating loss carrybacks from subsequent years, was $13,687,047.25. And it was determined that net operating losses were incurred by Old Aetna for the taxable year January 1 through December 29, 1964, in the amount of $7,213,547.00, and by the plaintiff for the taxable years December 30 through December 31, 1964, and 1965 in the amounts of $39,597.00 and $11,554,725.00, respectively.

9. Pursuant to said Forms 870-AD it was further determined that $2,052,316.50 of the $7,213,547.00 net operating loss for the taxable year January 1 through December 29, 1964, should be carried back to the taxable year 1962, reducing the taxable income for such 1962 year to $-0-, and that the $5,161,230.50 balance of such net operating loss should be carried back to the taxable year 1963, reducing the taxable income for such 1963 year to $8,525,816.75. No carryback of losses incurred by the plaintiff in the taxable year December 30 through December 31, 1964, or the taxable year 1965 was allowed or has ever been allowed.

10. Pursuant to said Forms 870-AD it was thus determined that Old Aetna's Federal income tax liability for the taxable years 1962 and 1963 was $-0- and $4,071,655.21, respectively. There had previously been paid by Old Aetna and/or the plaintiff to the defendant, with respect to Federal income taxes of Old Aetna for the taxable years 1962 and 1963, the sums of $656,747.17 and $2,886,942.44, respectively. A deficiency in Federal income tax for the taxable year 1963 in the amount of $1,184,712.77, and an overassessment of Federal income tax for the taxable year 1962 in the amount of $656,747.17, were thus determined.

11. Pursuant to the foregoing, on August 20, 1971, the defendant assessed said deficiency for the taxable year 1963 in the amount of $1,184,712.77, plus interest thereon. This was paid by the plaintiff through the defendant's application to such deficiency on the notice of assessment of the $656,747.17 overassessment for the taxable year 1962, and by the plaintiff's payment to the defendant on or about August 30, 1971, of the $527,965.60 balance of the deficiency plus interest assessed in the amount of $395,975.38.

12. The plaintiff is entitled to a carryback of its net operating loss for the taxable year December 30 through 31, 1964, in the amount of $39,597.00 and its net operating loss for the taxable year 1965 in the amount of $11,554,725.00 to the taxable year 1963 of Old Aetna. Since these net operating losses exceed the taxable income of $8,525,816.75 determined for such 1963 year pursuant to said Forms 870-AD, the plaintiff is entitled to a refund of the $4,071,655.21 Federal income taxes paid with respect to such 1963 year, plus the deficiency interest paid by it in the amount of $395,975.38, with interest as provided by law.

13. On December 27, 1967, within the period provided by law, the plaintiff filed with the District Director of Internal Revenue for Connecticut a claim for refund of the $2,886,942.44 theretofore paid with respect to the Federal income tax of Old Aetna for the taxable year 1963, with interest on the amounts so paid. A copy of such claim for refund is annexed hereto as Exhibit A.

14. By letter dated August 18, 1971, the plaintiff was notified by the Director of the Internal Revenue Service Center, North-Atlantic Region, that such claim for refund had been disallowed in full.

15. On September 26, 1972, within the period provided by law, the plaintiff filed with the District Director of Internal Revenue for Connecticut a claim for refund of the full $4,071,655.21 theretofore paid with respect to the Federal income tax of Old Aetna for the taxable year 1963 (including the $2,886,942.44 for which claim had previously been made and the $1,184,712.77 paid in August 1971 pursuant to the assessment dated August 20, 1971), plus the deficiency interest paid of $395,975.38, with interest on the amounts so paid. A copy of such claim for refund is annexed hereto as Exhibit B.

16. The plaintiff has received no notice from the defendant that the claim for refund filed September 26, 1972, has been denied, but more than six months have expired since it was filed.

17. By reason of the facts set forth in this complaint, there is now due and owing from the defendant to the plaintiff the sum of $4,071,655.21, plus deficiency interest of $395,975.38, with interest thereon at the rate of 6% per annum from the date of payment.

18. No part of the amounts which were unlawfully collected has been repaid or credited to the plaintiff or for its account.

19. No action has been had on the claims here presented, either in Congress or before any other branch of the United States Government.

20. The plaintiff is, and always has been, the sole and absolute owner of the claims here presented.

WHEREFORE, the plaintiff demands judgment in the aggregate amount of $4,467,630.59, representing $4,071,655.21 in tax plus $395,975.38 of deficiency interest, with interest thereon at the rate of 6% per annum from the date of payment, together with the costs and ~~disbursements~~ of this action, and such other relief as the Court may deem just and equitable.

Dated at Hartford, Connecticut, this 14th day of August, 1973.

William G. DeLana

William G. DeLana
Day, Berry & Howard
Attorneys for the Plaintiff
One Constitution Plaza
Hartford, Connecticut 06103

IN THE UNITED STATES DISTRICT COURT FOR THE

DISTRICT OF CONNECTICUT

THE AETNA CASUALTY AND SURETY COMPANY, for itself and as successor by merger to The Aetna Casualty and Surety Company, Plaintiff	
v.	CIVIL ACTION NO. H-131
UNITED STATES OF AMERICA, Defendant	

STIPULATION OF FACTS

IT IS HEREBY STIPULATED AND AGREED by and between the respective parties hereto, by their respective counsel, that for the purposes of this case the facts herein stated shall be taken as true and the documents herein contained are true and correct copies without stipulating that any particular fact or document is relevant; provided, however, that this stipulation shall be without prejudice to the right of either party to introduce upon the trial of this case any other and further evidence not at variance with the facts or documents herein stated.

1. The plaintiff, The Aetna Casualty and Surety Company (hereinafter referred to as "New Aetna"), is an insurance company duly organized and existing under and by virtue of the laws of the State of Connecticut engaged in the business of writing and selling liability, fire, theft, property damage,

and surety insurance, with its principal place of business at 151 Farmington Avenue, Hartford, Connecticut.

2. New Aetna is the successor by statutory merger, effected December 29, 1964, to The Aetna Casualty and Surety Company (hereinafter referred to as "Old Aetna"), which was an insurance company duly organized and existing under and by virtue of the laws of the State of Connecticut since 1883, engaged in the business of writing and selling liability, fire, theft, property damage, and surety insurance, with its principal place of business at 151 Farmington Avenue, Hartford, Connecticut.

3. Aetna Life Insurance Company (hereinafter referred to as "Aetna Life") is an insurance company duly organized and existing under and by virtue of the laws of the State of Connecticut since 1853. Aetna Life writes and sells life, accident, and health insurance throughout the United States and in Puerto Rico, Guam and Canada.

4. The controversy in this case relates to a corporate reorganization of Old Aetna that occurred on December 29, 1964, the characterization of which will control the Federal income tax treatment of a subsequent net operating loss, all as more particularly set forth herein.

5. As a result of stock splits and stock dividends, immediately preceding the reorganization of December 29, 1964, the outstanding stock of Aetna Life consisted of 20,000,000 shares of voting common stock.

6. Immediately preceding the reorganization of December 29, 1964, the outstanding stock of Old Aetna consisted of 7,000,000 shares of voting common stock, of which

Aetna Life held 4,312,535 shares (61.61 percent of the outstanding shares of Old Aetna), all acquired prior to 1957. The remaining 2,687,465 shares of Old Aetna which were outstanding immediately preceding the reorganization (38.39 percent of the outstanding shares of Old Aetna) were held by 3,952 other shareholders.

7. Immediately preceding the reorganization, 1,622 of the 3,952 Old Aetna shareholders, other than Aetna Life, held 1,368,243 of the 2,687,465 publicly owned shares of Old Aetna while concurrently holding 3,764,305 of the 20,000,000 outstanding shares of Aetna Life. In addition, 864,802 shares of the 2,687,465 publicly owned shares of Old Aetna were registered in the names of nominees in whose names there were concurrently registered 6,285,758 of the 20,000,000 outstanding shares of Aetna Life. The parties do not know whether, or the extent to which, the actual individuals or entities for whom the nominees held the stock of Old Aetna were the same individuals or entities for whom the nominees held the stock of Aetna Life.

8. The management of Old Aetna and Aetna Life proposed a plan of reorganization the effect of which was that Old Aetna would be merged with a newly formed corporation, New Aetna, and that the shareholders of Old Aetna would receive, for their interest in Old Aetna, shares of stock of Aetna Life. Subsequent to the reorganization the shares of New Aetna were placed in a trust for all of the shareholders of Aetna Life.

9. The Board of Directors of Old Aetna approved the plan of reorganization on September 3, 1964, and a copy of the minutes of the Board of Directors' meeting of that date is attached hereto as Exhibit A.

10. The Board of Directors of Aetna Life approved the plan of reorganization on September 3, 1964, and a copy of the minutes of the Board of Directors' meeting of that date is attached hereto as Exhibit B.

11. On September 9, 1964, and supplemented by letters dated September 22 and September 28, 1964, Aetna Life filed a ruling request with the Internal Revenue Service which related to the Federal income tax consequences of the proposed reorganization, a copy of each of which is attached hereto as Exhibit C.

12. On October 21, 1964, the Insurance Commissioner of the State of Connecticut issued a Finding and Final Order relative to the proposed reorganization, a copy of which is attached hereto as Exhibit D.

13. On October 23, 1964, the Commissioner of Internal Revenue, acting through his duly authorized delegate, issued a ruling letter holding that the reorganization would constitute a tax-free reorganization described in Section 368(a)(1)(C) of the Internal Revenue Code of 1954, as amended. A copy of said ruling letter is attached hereto as Exhibit E. Aetna Life is referred to in Exhibit E as "Aetna Life"; Old Aetna is referred to in Exhibit E as "Aetna Casualty"; and

New Aetna is referred to in Exhibit E as "New". The reorganization and the subsequent distribution of the New Aetna shares to the stapled trust was effected as set forth in Exhibits C and E.

14. On October 26, 1964, Old Aetna and Aetna Life each mailed to their shareholders a notice of shareholders' meeting of November 24, 1964, copies of which are attached hereto as Exhibits F and G, respectively. Each shareholder of Old Aetna and Aetna Life received along with the notice of shareholders' meeting a proxy statement, a copy of which is attached hereto as Exhibit H.

15. The plan of reorganization was adopted and was approved by the shareholders of Old Aetna and Aetna Life on November 24, 1964.

16. Pursuant to the plan of reorganization, Aetna Life organized New Aetna (under the name of Farmington Valley Insurance Company) and, on December 29, 1964, issued 13,300,000 shares of its voting common stock to New Aetna in exchange for all (1,000 shares) of the shares of New Aetna.

17. Pursuant to the plan of reorganization, on December 29, 1964, Old Aetna was then merged into New Aetna pursuant to Connecticut law, and New Aetna changed its name from Farmington Valley Insurance Company to The Aetna Casualty and Surety Company.

18. Pursuant to the plan of reorganization, on December 29, 1964, New Aetna then exchanged 1.9 shares of the voting common stock of Aetna Life with the shareholders of

Old Aetna, including Aetna Life, for each of the 7,000,000 shares of Old Aetna owned by them. All of the stock of Old Aetna was immediately canceled. The Aetna Life common stock received by Aetna Life was immediately retired and restored to the status of authorized but unissued stock.

19. Aetna Life paid none of the expenses incurred in the reorganization by Old Aetna or New Aetna, nor did Old Aetna or New Aetna pay any of the expenses incurred in the reorganization by Aetna Life.

20. No shareholders of Old Aetna received cash in lieu of shares of Aetna Life, since no shareholders of Old Aetna exercised the statutory right of appraisal accorded dissenting shareholders under Connecticut law.

21. On December 30, 1964, Aetna Life distributed all of the shares of New Aetna to a trust (the "stapled trust") for the benefit of all the shareholders of Aetna Life. A copy of the trust agreement is attached hereto as Exhibit I. The shares of New Aetna were stapled to the Aetna Life shares such that none of the shares of either corporation could be acquired or transferred thereafter without the stapled shares of the other corporation.

22. Prior to the reorganization, New Aetna had no existence apart from the mere fact of its incorporation, having conducted no business and having had no income or assets.

23. On December 29, 1964, as a result of the reorganization, New Aetna became, by operation of law, the owner of all of the property, assets, debts due to, rights, powers,

privileges and franchises of Old Aetna, and became subject to all the liabilities, debts, and duties of Old Aetna.

24. On December 29, 1964, as a result of the reorganization the existence of Old Aetna merged with New Aetna and Old Aetna ceased to exist.

25. By order of the Insurance Commissioner of the State of Connecticut, New Aetna succeeded to the license to do insurance business of Old Aetna in Connecticut upon the consummation of the reorganization.

26. New Aetna assumed the business of Old Aetna and operated it in essentially the same fashion as Old Aetna had. Changes occurring subsequent to December 29, 1964 resulted from the evolution of business operations, not as a direct consequence of or in connection with the reorganization.

27. Prior to the reorganization Old Aetna, and thereafter New Aetna, shared with Aetna Life the use of accounting facilities, personnel operations, a legal department, purchasing and supply operations, internal auditing staff, electronic data processing equipment, a field claims department, and the same building for their home offices.

28. The directors and the senior officers of Aetna Life and Old Aetna were identical for several years before the reorganization. The directors and the senior officers of Aetna Life and New Aetna were identical immediately after the reorganization. Aetna Life supervised the operations of New Aetna to the extent it had supervised the operations of Old Aetna.

29. The corporate rights, powers, privileges, and franchises stated in the Certificate of Incorporation of Old Aetna were adopted in full in New Aetna's Certificate of Incorporation.

30. The Bylaws of Old Aetna immediately before the reorganization were adopted in full as the Bylaws of New Aetna thereafter.

31. The Internal Revenue Service employer identification number of Old Aetna was the identification number of New Aetna after the reorganization.

32. The adjusted basis in the hands of Old Aetna for its assets immediately before the reorganization became the adjusted basis in the hands of New Aetna for the assets it acquired from Old Aetna thereby.

33. With respect to the total taxable income (loss) for Old Aetna and New Aetna for the full calendar year 1964, 99.45355 percent is allocable to Old Aetna for 364 days and .54645 percent is allocable to New Aetna for two days. A net operating loss was incurred for the full calendar year 1964 in the amount of $7,253,144.00, of which $7,213,547.00 is allocable to Old Aetna for 364 days and $39,597.00 is allocable to New Aetna for two days.

34. New Aetna incurred a net operating loss in the amount of $11,554,725.00 for the calendar year 1965. The net operating losses incurred by New Aetna from December 29, 1964 through December 31, 1965 were in connection with the business activity which had formerly been carried on by Old Aetna prior to the reorganization, and the business activity carried on by New Aetna thereafter.

35. Old Aetna had taxable income for the calendar year 1963 in the amount of $8,525,816.75, after the application of the carryback of the net operating loss incurred for the 364-day period January 1 through December 29, 1964.

36. Old Aetna and New Aetna have paid to the defendant with respect to such taxable income determined for the calendar year 1963 the total amount of $4,071,655.21 in Federal income taxes and $395,975.38 in deficiency interest, no part of either of which has been returned or in any way refunded or credited.

37. In connection with the audit of the plaintiff's Federal income tax return for the calendar year 1965, the District Director of Internal Revenue having jurisdiction over the return requested and received the memorandum of technical advice attached hereto as Exhibit J.

38. No taxpayer has ever been allowed, through Forms 870-AD or otherwise, the benefit of carrybacks to the calendar year 1963 of the net operating losses incurred by New Aetna in the two days December 30 through December 31, 1964 or in the calendar year 1965. Old Aetna would have been entitled to a carryback of these net operating losses to the calendar year 1963 if the reorganization had not occurred and Old Aetna had continued to carry on its business.

39. The plaintiff timely filed claims for refund seeking the benefit of the carryback to the calendar year 1963 of the net operating losses incurred by it in the two days December 30 through December 31, 1964, and in the calendar year 1965. Such claims have not been allowed, and this action was timely commenced.

40. If a net operating loss incurred by the plaintiff subsequent to the reorganization may be carried back to taxable periods before the reorganization, the net operating losses incurred by the plaintiff in the two days December 30 through December 31, 1964, and in the calendar year 1965 would properly be carried back to Old Aetna for the calendar year 1963, and the plaintiff would be entitled in this action to a judgment ordering the refund by the defendant to New Aetna of the $4,071,655.21 of Federal income taxes paid for the calendar year 1963 and the $395,975.38 of deficiency interest paid with respect thereto, with interest on such amounts as provided by law.

41. If a net operating loss incurred by the plaintiff subsequent to the reorganization may not be carried back to taxable periods before the reorganization, the plaintiff is entitled to recover nothing herein.

Dated at Hartford, Connecticut, this ____ day of ____, 1974.

PLAINTIFF

By: ____________________
William G. DeLana
Its Attorney

DEFENDANT

By: ____________________
Robert M. Greco
Its Attorney

PAUL, WEISS, RIFKIND, WHARTON & GARRISON

575 MADISON AVENUE, NEW YORK, N.Y. 10022

MURRAY HILL 8-5600

CABLE: LONGSIGHT, N.Y.

ARTHUR J. COHEN
COUNSEL

RANDOLPH E. PAUL
LOUIS S. WEISS

September 9, 1964

Hon. Bertrand M. Harding
Acting Commissioner of Internal Revenue
Internal Revenue Service
Washington 25, D. C.

Aetna Life Insurance Company
Employer Identification No. 06-0237850

The Aetna Casualty and Surety Company
Employer Identification No. 06-6033504

Dear Commissioner Harding:

On behalf of Aetna Life Insurance Company ("Aetna Life") and The Aetna Casualty and Surety Company ("Aetna Casualty"), we respectfully request the issuance of rulings as to the tax consequences of a reorganization and distribution of stock involving the two companies.

Facts

Aetna Life is a company organized under the laws of the State of Connecticut in 1853. It writes and sells the major types of life insurance and accident and health insurance throu[ghout] the United States and in Puerto Rico and Canada. It has be[en] in business for more than a century. At December 31, 1963, Aet[na]

Life had total assets in excess of 4.9 billion dollars and capital and surplus in excess of $400,000,000. A copy of the balance sheet of Aetna Life at December 31, 1963, taken from its Annual Statement prepared to meet the requirements of the National Association of Insurance Commissioners, is enclosed as Exhibit A. Aetna Life has outstanding 8,000,000 shares of $5 par value voting common stock, which is traded in the over-the-counter market.

Aetna Casualty was organized under the laws of the State of Connecticut in 1883 and commenced business in 1907. It is engaged in the business of writing and selling liability, fire, theft, property damage and surety insurance throughout the United States and in Guam, Puerto Rico and Canada. At December 31, 1963 Aetna Casualty had total assets in excess of $950,000,000 and capital and surplus in excess of $320,000,000. A copy of the balance sheet of Aetna Casualty at December 31, 1963, taken from its Annual Statement prepared to meet the requirements of the National Association of Insurance Commissioners is enclosed as Exhibit B. Aetna Casualty has outstanding 7,000,000 shares of $3.50 par value voting common stock, of which Aetna Life now owns 4,342,914 shares, or 62.04 percent. The remaining stock of Aetna Casualty is traded in the over-the-counter market and is held by approximately four thousand shareholders.

Aetna Life has at all times since 1907 owned more than 50 percent of the outstanding stock of Aetna Casualty.[1/] Since December 31, 1957, the only increase in Aetna Life's percentage stock ownership of Aetna Casualty occurred in September, 1960, when Aetna Life acquired the equivalent of 30,378 shares (adjusted for a subsequent two-for-one stock split) of Aetna Casualty stock by purchase in the over-the-counter market. Aetna Life has not transferred any property to Aetna Casualty since 1957.

Aetna Life's controlling stock interest in Aetna Casual[ty] has permitted a high degree of integration of the operations of both companies, with resulting business benefits. For example, the home offices of both companies are operated together in a single building in Hartford, Connecticut. The companies also share the use of accounting facilities, personnel operations, the legal department, purchasing and supply, internal auditing, electronic data processing equipment and the field claims department- ment.

The most important advantage of the relationship of Aetna Life and Aetna Casualty has been in the area of sales. The[re] has been a significant trend in the insurance industry toward offering full-line insurance; that is, an affiliated group of companies with the same trade name and identified in the public mind

1/ Aetna Life also owns and will continue to own a majority of the stock of The Excelsior Life Insurance Company of Toronto, Canada.

as one company will offer both life and casualty insurance. The primary advantage of offering full-line insurance lies in the ability to attract insurance agents who are influential in the placement with a single affiliated group of all the life, fire, casualty, bonding and other insurance needs of their clients.

Because of the trend toward full-line insurance and because of the view of the management of Aetna Life that state laws will permit greater flexibility in the future with respect to permitting certain types of insurance to be written by either life or casualty insurance companies, the management of Aetna Life has for the past several years considered it desirable to create a complete identity of ownership of Aetna Life and Aetna Casualty. Creation of such identity of ownership would permit the management of both companies to make discretionary business decisions without concern for conflicting stockholder interests.

Under the law as it stood prior to the amendment of section 815 of the Code last week as the result of enactment of H.R. 5739, it was a practical impossibility for Aetna Life to achieve the desired identity of ownership of Aetna Life and Aetna Casualty. Under the Life Insurance Company Income Tax Act of 1959, Aetna Life is subject to additional income tax liability solely because of its ownership of Aetna Casualty stock. Any increase of assets of Aetna Life resulting from acquisition of additional Aetna Casualty stock would generate an increase in Aetna Life's tax liability even if the additional stock acquired bore no dividends. (Subsequent receipt of dividends would mean a subsequent

increase of tax liability over and above that generated by the asset increase.)[2]

On the other hand, prior to last week's amendment of section 815, Aetna Life could not have acquired the outstanding minority interest in Aetna Casualty and thereafter distributed the Aetna Casualty stock to the Aetna Life stockholders without the imposition of an enormous tax by reason of that section. H.R. 5739 amended section 815 to permit Aetna Life to create the desired identity of ownership of Aetna Life and Aetna Casualty without suffering the adverse tax consequences that would have resulted prior to such amendment.

In order to accomplish the desired identity of stock ownership of Aetna Life and Aetna Casualty in compliance with section 815 as amended, Aetna Life and Aetna Casualty have now evolved the following plan contemplating the reorganization of Aetna Casualty and the distribution of the stock of the reorganized company to the shareholders of Aetna Life by means of a so-called stapled trust. Aetna Life will cause a new corporation ("New Corporation") to be organized under the Stock Corporation Act of Connecticut and will transfer to New Corporation shares of Aetna Life in exchange for all of the stock (expected to be 1,000 shares) of New Corporation. Aetna Casualty will then be merged into New

2/ Under the Life Insurance Company Income Tax Act of 1959, the higher the average earnings rate on investments, the lower the tax liability and vice versa. Therefore, an increase in low-yielding assets lowers the earnings rate and increases the tax liability.

Corporation in accordance with the Connecticut Stock Corporation Act and the Aetna Casualty charter, and the shareholders of Aetna Casualty, including Aetna Life, will receive 1.9 shares of Aetna Life stock for each share of Aetna Casualty.3/ The Aetna Casualty stock will be cancelled on the merger.. As a result, Aetna Life will, immediately following the merger, own all of the stock of New Corporation, which will have succeeded to the business and assets of Aetna Casualty, and Aetna Casualty will have ceased to exist as a separate corporation.4/

Aetna Life may thereupon contribute cash to New Corporation in an amount not in excess of that deemed necessary to pay off dissenting Aetna Casualty shareholders and to pay expenses of the transaction. Immediately following such cash contribution, if any, Aetna Life will distribute the stock of New Corporation to its shareholders pursuant to arrangements whereby the New Corporation stock will be stapled to the Aetna Life stock. Under the plan, Aetna Life will transfer the stock of New Corporation to a trustee, approved by its shareholders, who will hold the stock for the benefit of the shareholders in accordance with the terms of the trust instrument. Legal title will be vested in the trustee with all dividend and voting rights reserved to the beneficiary shareholders. After the distribution, no shares of either company may be acquired or transferred without the stapled share of the other. We expect to be able to send you a draft of the trust instrument in a few days.

3/ Dissenting Aetna Casualty shareholders will be entitled to receive the fair value of their shares in cash under the Connecticut Stock Corporation Act.

4/ The New Corporation will own more than 99 percent of the stock of The Standard Fire Insurance Company, which stock interest is now owned by Aetna Casualty.

To the knowledge of Aetna Life, there have been no arrangements by the Aetna Life shareholders for the sale or exchange of the Aetna Life or New Corporation stock after the proposed transaction.

It is contemplated that the transfer of Aetna Life shares to New Corporation, the merger of Aetna Casualty into New Corporation, the contribution by Aetna Life of cash to New Corporation and the distribution of the New Corporation stock to a trust for the benefit of the Aetna Life shareholders will take place successively on December 31, 1964.

It will be necessary to have meetings of the Aetna Life and Aetna Casualty shareholders to approve the reorganization and distribution of the New Corporation stock to the trust. At the Aetna Life meeting, the Aetna Life shareholders will also be asked to approve a two-for-one split of Aetna Life shares and a 25 percent stock dividend on the split shares. If the stock split and stock dividend are approved, they will be effective prior to the reorganization; as a result, Aetna Life would have 20,000,000 shares outstanding at the time of the reorganization. 5/

Rulings Requested

On the basis of the foregoing, it is respectfully requested that you issue the following rulings:

5/ Following the reorganization a[illegible] prior to the distribution of New Corporation stock, Aetna [illegible]fe may purchase up to 48,000 shares of its stock on th[illegible] market in order to leave exactly 25 million shares outstanding.

1. The two-for-one split of Aetna Life's common stock will constitute a recapitalization within the meaning of section 368(a)(1)(E) of the Internal Revenue Code of 1954.

2. The payment of the 25 percent stock dividend on the outstanding stock of Aetna Life will constitute a distribution of stock not includible in the gross income of Aetna Life's shareholders by reason of section 305(a).

3. The issuance of Aetna Life stock to New Corporation in exchange for the stock of New Corporation will constitute an exchange with respect to which gain or loss is not recognized by reason of section 351(a).

4. The merger of Aetna Casualty into New Corporation and the transfer of the Aetna Life stock held by New Corporation to the shareholders of Aetna Casualty on such merger will constitute a reorganization within the meaning of section 368(a)(1)(C).

5. By reason of section 354, the shareholders of Aetna Casualty will not recognize any gain or loss on the receipt of Aetna Life stock on such reorganization.

6. The basis of the Aetna Life stock received by each Aetna Casualty shareholder on the merger will be equal to the basis to such shareholder of the Aetna Casualty stock extinguished on such merger (section 358).

7. The holding period of the Aetna Life stock received by each Aetna Casualty shareholder on the merger will include the holding period for which the Aetna Casualty stock being extinguished on the merger had been held by such shareholder (section 1223(1)).

8. By reason of section 361 New Corporation will not recognize any gain or loss on such reorganization, and by reason of section 362 New Corporation will succeed to the basis of Aetna Casualty for the assets acquired from Aetna Casualty on the merger.

9. The transfer of the New Corporation stock by Aetna Life to a trustee for the benefit of its shareholders will not constitute a distribution within the meaning of section 815 except to the extent of (i) the cash contributed by Aetna Life to New Corporation and (ii) the cost to Aetna Life of Aetna Casualty stock purchased after December 31, 1957.

10. The transfer of the New Corporation Stock by Aetna Life to a trustee for the benefit of its shareholders will constitute a distribution within the meaning of section 355 of the Code. No gain or loss will be recognized to Aetna Life or to its shareholders as a result of the distribution (sections 311, 355).

11. Pursuant to section 358 of the Code and section 1.358-2 of the regulations, the basis of the stock of Aetna Life will be allocated between such stock and the

stock of New Corporation received, in proportion to the respective fair market value of each on the date of distribution.

12. The holding period of New Corporation stock received by each shareholder of Aetna Life will include the holding period for which the Aetna Life stock has been held or is deemed (by reason of Ruling No. 7) to have been held by such shareholder (section 1223(1)).

A memorandum in support of the requested rulings is enclosed as Exhibit C. We also enclose a power of attorney authorizing our representation of Aetna Life and Aetna Casualty.

As we have noted above, the contemplated reorganization of Aetna Life and Aetna Casualty has been made possible by the enactment last week of H.R. 5739, which was designed to permit elimination of the inequitable tax burden that had been imposed on companies such as Aetna Life by reason of the ownership of a subsidiary such as Aetna Casualty. H.R. 5739 amended section 815 effective December 31, 1963, so as to permit elimination of the inequitable tax burden for the taxable year 1964. In order to remove the tax burden for 1964, the entire transaction must be completed by December 31, 1964.

Moreover, Aetna Life and Aetna Casualty were reasonably certain that once H.R. 5739 became law, sophisticated stock analysts

would start speculating on the mechanics by which Aetna Life would create a complete identity of Aetna Life and Aetna Casualty stock ownership, and therefore on the ratio for the exchange of Aetna Life stock for Aetna Casualty stock. In order to prevent gyrations in the market values of Aetna Casualty and Aetna Life shares, the management of both companies felt it important that promptly after enactment of H.R. 5739 the plan of reorganization be publicly announced and the ratio fixed. This was in fact done last Thursday, September 3, 1964. The ratio of exchange could be fixed at this time only as part of a decision promptly to effect the transaction. For this reason too, therefore, it is imperative that the reorganization be completed by December 31, 1964.

Shareholders' meetings of the two companies to approve the transactions have been tentatively scheduled for November 24, and it is planned that the notice of shareholders' meeting and proxy statement be mailed to each Aetna Life and each Aetna Casualty shareholder not later than October 23, 1964. It is considered important that the proxy statement to be mailed to each Aetna Life and Aetna Casualty shareholder reflect the tax effects of the reorganization. Accordingly, it is essential that the requested rulings be issued by October 20, 1964. We will greatly appreciate your cooperation in expediting consideration of this application in order to meet such time schedule.

If you have any questions or if you need any additional information, please do not hesitate to call me collect. If you

think a conference will be helpful, please call me so that we can promptly arrange ~~one.~~

Sincerely,

Adrian W. DeWind

PAUL, WEISS, RIFKIND, WHARTON & GARRISON

575 MADISON AVENUE, NEW YORK, N.Y. 10022

MURRAY HILL 8-6600

CABLE: LONGSIGHT, N.Y.

September 22, 1964

Hon. Bertrand M. Harding
Acting Commissioner of Internal Revenue
Internal Revenue Service
Washington 25, D. C.

Attn: T:R:R

Re: Aetna Life Insurance Company
The Aetna Casualty and Surety Company

Dear Commissioner Harding:

By letter dated September 9, 1964, we submitted a ruling application in connection with a proposed reorganization and distribution of stock involving the above companies.

As we stated in our letter of September 9, 1964, Aetna Life Insurance Company will transfer the stock of a newly organized subsidiary to a trustee for the benefit of the shareholders of Aetna Life. We stated that we would send you a draft of the trust instrument when it was prepared, and we now enclose such draft herewith.

We also wish to advise you that Aetna Casualty shareholders who become entitled to receive fractional shares of Aetna Life stock on the reorganization will be given the choice of buying sufficient fractions to round out their holdings or of selling their fractional interests.

Sincerely yours,

Adrian W. DeWind

Enc.

PAUL, WEISS, RIFKIND, WHARTON & GARRISON
575 MADISON AVENUE, NEW YORK, N.Y. 10022
[illegible]
CABLE: [illegible]

September 28, 1964

Hon. Bertrand M. Harding
Acting Commissioner of Internal Revenue
Internal Revenue Service
Washington 25, D. C.

Attn: T:R:R

Re: Aetna Life Insurance Company
The Aetna Casualty and Surety Company

Dear Commissioner Harding:

By letter dated September 9, 1964, supplemented by letter dated September 22, 1964, we have applied for rulings in connection with a proposed reorganization and distribution of stock involving the above companies.

We now wish to advise you of the following changes in or additions to the information previously supplied to you:

1. On the 25 percent stock dividend to be issued by Aetna Life prior to the reorganization with Aetna Casualty, Aetna Life shareholders may become entitled to receive fractional shares. Such shareholders will be given the right to sell such fractions or to buy enough additional stock to make a whole share.

2. Aetna Life has decided to sell the 30,378 shares of Aetna Casualty stock deemed purchased by Aetna Life in September 1960. Such sale will be consummated before the Aetna Life and Aetna Casualty shareholders vote on the proposed reorganization.

3. Aetna Casualty will, prior to the effective date of the merger into New Corporation, establish a trust consisting of cash in an amount not in excess of 10 percent of the total assets of Aetna Casualty. Such trust will provide that the cash held therein will be used to pay dissenting

Hon. Bertrand M. Harding
Acting Commissioner of Internal Revenue
Internal Revenue Service

September 28, 1964

shareholders of Aetna Casualty and that any balance remaining after payment of the dissenting shareholders shall be paid over to New Corporation.

4. Under Connecticut law, the expenses involved in the merger of Aetna Casualty into New Corporation are the liability of the surviving corporation, which is here New Corporation. Accordingly, New Corporation will pay the expenses of the merger other than the amounts payable to dissenting shareholders of Aetna Casualty. The expenses payable by New Corporation will not, however, include the amounts properly chargeable to Aetna Casualty shareholders with respect to the sale or purchase of fractional shares of Aetna Life stock received on the reorganization. The Aetna Casualty shareholders will be required to pay the stamp taxes and brokerage commissions incurred in connection with the purchase or sale of fractional shares.

We enclose two copies of a memorandum, requested by Mr. John F. Bogaard of your office, dealing with the applicability of section 355 to the distribution of stock of New Corporation.

I believe that the information furnished herewith and the enclosed memorandum will enable you to complete your work on the ruling application. As you know, time is of the essence. Aetna Life and Aetna Casualty plan to mail proxy statements for their November shareholders' meetings about October 23. We would greatly appreciate it if issuance of the requested rulings could be accomplished by October 20, 1964.

Sincerely yours,

Adrian W. DeWind

Enc.

IN THE MATTER OF	
ÆTNA LIFE INSURANCE COMPANY	October 21, 1961
THE ÆTNA CASUALTY AND SURETY COMPANY	Before the
AND	Insurance Commissioner
FARMINGTON VALLEY INSURANCE COMPANY	State of Connecticut

FINDING AND FINAL ORDER

This matter came before me on September 18, 1961 by Petition filed by Ætna Life Insurance Company ("Ætna Life"), The Ætna Casualty and Surety Company ("Ætna Casualty") and Farmington Valley Insurance Company ("Farmington") (collectively called the "Petitioners") and thence to the present time when the Petitioners appeared and offered evidence in support of the Petition. On the basis of the evidence and other information on file in my office, I hereby find:

1. That the Petition filed on September 18, 1961 is in full compliance with the provisions of Title 38 of the General Statutes of Connecticut, as amended, and that jurisdiction over the matters set forth in said Petition is vested in me under said Title, including Sections 38-35 and 38-42 of said Title;

2. That the Petitioners have given due notice of the public hearing as directed by me in my Order of Notice dated September 18, 1961 and all policyholders and shareholders of the Petitioners and other interested parties were given the opportunity to appear and to be heard at the public hearing held before me on October 19, 1961 pursuant to said notice;

3. That each of the allegations of said Petition dated September 18, 1961 is true and accurate;

4. That Ætna Life is a domestic life insurance company specially chartered by the Connecticut General Assembly, with its principal office at 151 Farmington Avenue, Hartford; that its outstanding capital stock is $40,000,000, consisting of 8,000,000 shares of $5 par value each;

5. That Ætna Casualty is a domestic fire and casualty insurance company, specially chartered by the Connecticut General Assembly, with its principal office at 151 Farmington Avenue, Hartford; that its outstanding capital stock is $24,500,000, consisting of 7,000,000 shares of $3.50 par value each;

6. That Farmington is a domestic fire and casualty insurance company, formed under the Connecticut Stock Corporation Act, with its principal office at 151 Farmington Avenue, Hartford; that its authorized capital stock is $500,000, consisting of 1,000 shares of $500 par value each, none of which has been issued;

7. That prior to the proposed issue and exchange of stock by and between Ætna Life and Farmington and prior to the proposed merger of Ætna Casualty into Farmington, Ætna Life will reduce the par value of its shares of capital stock from $5 to $2.50 per share and will increase its authorized shares from 8,000,000 shares to 20,000,000 shares in order to effect a 2-for-1 stock split and to provide for payment of a 25% stock dividend on the shares outstanding immediately after the stock split;

8. That prior to said proposed merger Ætna Life will issue not more than 13,300,000 shares of its $2.50 par value capital stock to Farmington in exchange for all of the authorized shares of Farmington's $500 par value capital stock;

9. That the terms and conditions of the proposed merger of Ætna Casualty into Farmington are as set forth in the Plan of Merger dated October 16, 1964.

10. That Ætna Life will restore to the status of authorized but unissued shares those shares of its own capital stock received by it as a result of the merger;

11. That following the effective date of the merger, Ætna Life will distribute all shares of capital stock of the new Ætna Casualty (Farmington) to Hartford National Bank and Trust Company, Hartford, Connecticut, as Trustee, to be held in trust under a Trust Agreement for the pro rata benefit of the holders of record of shares of capital stock of Ætna Life;

12. That with respect to the issue and exchange of stock referred to in Paragraph 8 above and with respect to the merger and other transactions referred to in Paragraphs 9 and 10 above, the interests of the policyholders and shareholders of Ætna Life and Ætna Casualty are protected and the terms and conditions thereof are fair and reasonable.

On the basis of the foregoing Finding the following are hereby approved:

(a) The reduction in the par value of the shares of the capital stock of Ætna Life from $5 to $2.50 per share;

(b) The issue and delivery by Ætna Life to Farmington of not in excess of 12,000,000 shares of $2.50 par value capital stock of Ætna Life in exchange for the issue and delivery by Farmington to Ætna Life of all of the authorized $500 par value capital stock of Farmington;

(c) The merger of Ætna Casualty into Farmington on the terms described in the Plan of Merger;

(d) The restoration by Ætna Life to the status of authorized but unissued capital stock of the shares of capital stock of Ætna Life to be received by it on the merger of Ætna Casualty into Farmington;

THEREFORE, IT IS HEREBY ORDERED:

(1) That the original copy of this Finding and Final Order be made a part of the permanent records of the Connecticut Insurance Department;

(2) That Ætna Life and Ætna Casualty mail to each of their respective shareholders a Proxy Statement substantially similar to the Proxy Statement submitted in these proceedings as Exhibit E, which shall include a copy of this Finding and Final Order;

(3) That Ætna Life and Ætna Casualty make return to me of their doings pursuant to Paragraph (2) of this Order;

(4) That the Petitioners bear all expenses in connection with these proceedings as required by law.

7. That prior to the proposed issue and ... Farmington and prior to the proposed merger of Ætna ...

Witness my hand and OFFICIAL SEAL at Hartford, Connecticut, this 21st day of October, 1964.

/s/ WILLIAM R. COTTER

William R. Cotter

Insurance Commissioner

U. S. TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
WASHINGTON 25, D. C.

T:R:R
AJG

OCT 23 1964

Mr. Adrian W. DeWind
575 Madison Avenue
New York, New York 10022

In re: Aetna Life Insurance Company
Account No. 06-0237350

Dear Mr. DeWind:

This is in reply to a letter dated September 9, 1964, requesting a ruling with respect to the Federal income tax consequences of a proposed transaction by Aetna Life Insurance Company (hereinafter called "Aetna Life"). Additional information was also submitted in letters dated September 22, September 28 and October 9, 1964. The relevant facts submitted for consideration are substantially as set forth below.

Aetna Life, a Connecticut life insurance company organized in 1853, writes and sells the major types of life insurance and accident and health insurance throughout the United States and in Puerto Rico and Canada. It has 8,000,000 shares of $5.00 par value voting common stock presently outstanding. The Aetna Life stock is sold on the over-the-counter market.

The Aetna Casualty and Surety Company (hereinafter called "Aetna Casualty"), account number 06-6033504, is a Connecticut corporation which commenced business in 1907. It is engaged in the business of writing and selling liability, fire, theft, property damage and surety insurance throughout the United States and in various other areas. Aetna Casualty has 7,000,000 shares of $3.50 par value voting common stock outstanding, of which Aetna Life owns 4,342,914 shares, or 62.04 percent. The remaining Aetna Casualty stock is also traded in the over-the-counter market and is held by approximately 4,000 shareholders.

Since 1907, Aetna Life has at all times owned more than 50 percent of the outstanding stock of Aetna Casualty. The only increase in Aetna Life's percentage stock ownership of Aetna Casualty

since December 31, 1957, occurred in September 1960, at which time Aetna Life acquired the equivalent of 30,378 shares (adjusted for a subsequent two-for-one stock split) of Aetna Casualty stock by purchase on the over-the-counter market. It is stated that Aetna Life has not transferred any property to Aetna Casualty since 1957.

As a result of Aetna Life's controlling interest in Aetna Casualty, there has been a high degree of integration of the operations of both companies, including the sharing of the same home office building and the use of the same accounting, personnel, legal and other jointly operated departments. However, the most important advantage of the relationship of Aetna Life and Aetna Casualty has been the close identification of the two corporations in the mind of the public.

It is indicated that there has been a significant trend in the insurance business toward offering full line insurance. This is accomplished by having an affiliated group of companies with the same trade name identified in the public mind as a single company offering both life and casualty insurance. Because of this trend, the management of Aetna Life considers it desirable to create a complete identity of ownership of Aetna Life and Aetna Casualty. It is stated that the creation of such identity of ownership would permit the management of both corporations to make decisions without concern for conflicting shareholder interests.

In order to accomplish the desired identity, Aetna Life proposes to organize a new corporation (hereinafter called "New") pursuant to the laws of Connecticut. Aetna Life will transfer shares of its own stock to New in exchange for all of the outstanding stock of New. All of the assets of Aetna Casualty except sufficient cash to pay the dissenting shareholders of Aetna Casualty, which will not exceed 10 percent of its total assets, will be acquired by New in exchange for stock of Aetna Life. Any balance remaining after payment to the dissenting shareholders will be paid to New, which will succeed to the assets, liabilities and business of Aetna Casualty. The shareholders of Aetna Casualty will receive 1.9 shares of Aetna Life for each share of Aetna Casualty. Following the exchange, the Aetna Casualty stock will be cancelled.

Immediately following the acquisition of the assets of Aetna Casualty and the exchange of stocks, the stock of New will be distributed to a trust for the benefit of all Aetna Life

shareholders. Pursuant to a trust agreement to be approved by the Aetna Life shareholders, each shareholder will own a pro rata share of the New stock, based upon his ownership of the outstanding stock of Aetna Life. The New stock will be stapled to the stock of Aetna Life. The Hartford National Bank and Trust Company will be the trustee of the proposed trust and will represent the shareholders as required under the trust agreement, which is incorporated herein by reference. Legal title to the New stock will be vested in the trustee, with all voting and dividend rights reserved for the beneficiary shareholders. None of the stock of either corporation will be acquired or transferred thereafter without the stapled stock of the other corporation.

Prior to the transactions described above, it is also proposed that the stock of Aetna Life be split on a two-for-one basis followed by a 25 percent stock dividend. If the stock split and stock dividend are consummated, Aetna Life will have 20,000,000 shares outstanding at the time of the reorganization involving Aetna Casualty. After the reorganization with Aetna Casualty, it is anticipated that Aetna Life will have more than 25,000,000 shares of stock outstanding. It is stated that Aetna Life may purchase up to 48,000 shares of its stock on the open market after such reorganization but prior to the distribution of New stock to its shareholders in order to leave exactly 25,000,000 shares outstanding.

With respect to the 25 percent stock dividend, the Aetna Life shareholders who will become entitled to receive fractional shares will be given the right to sell such fractional interests or buy additional fractions to make a whole share. The Aetna Casualty shareholders, who will become entitled to receive fractional shares of Aetna Life stock, as a result of the acquisition of the Aetna Casualty assets by New, also will be given the right to buy or sell fractional interests to round off their holdings to a whole share.

Aetna Life will sell the 30,378 shares of Aetna Casualty stock which it owns as a result of the purchase in September 1960.

To the knowledge of Aetna Life, there have been no arrangements by the Aetna Life shareholders for the sale or exchange of the Aetna Life or New stock after the consummation of the proposed transaction.

New will pay the expenses of the acquisition of Aetna Casualty assets, except for the amount payable to the dissenting shareholders of Aetna Casualty and the cost incurred by the Aetna Casualty shareholders upon the purchase or sale of fractional interests.

It is stated that New will be an insurance company subject to the tax imposed by section 831 at the time of the distribution of its stock by Aetna Life.

Based solely on the information submitted, it is held as follows:

(1) The distribution of common stock by Aetna Life to its shareholders as a result of the two-for-one stock split followed by a 25 percent stock dividend, will not result in taxable income to such shareholders (section 305(a) of the Code).

(2) In accordance with section 307(a), the basis of the total number of shares of Aetna Life stock held by a shareholder after the receipt of the stock distribution (including fractional shares to which he may be entitled) will be the same as the cost or other basis of the total number of shares held by the shareholder prior to the receipt of the distribution.

(3) Where fractional shares are purchased to create a whole share, the basis of such a share will be the properly allocated basis of the fractional interest owned by the shareholder plus the cash paid to buy additional fractions necessary to acquire a full share. Such share will have a split holding period. That part of the share which is attributable to the fractional interest owned by the shareholder will include the holding period of the Aetna Life stock upon which the fractional interest was distributed. That part of the share which is attributable to fractional interests purchased will have a holding period beginning with the date following the date of the acquisition.

(4) The acquisition by New of substantially all of the assets and the assumption of the liabilities of Aetna Casualty in exchange solely for voting stock of Aetna Life will constitute a reorganization within the meaning of section 368(a)(1)(C) of the Code. For the purpose of this ruling "substantially all" means at least 90% of the fair market value of the net assets of Aetna Casualty. No gain or loss will be recognized to New on the exchange of the voting stock of Aetna Life for the assets of Aetna Casualty.

(5) The basis of the Aetna Casualty assets in the hands of New will be the same as the basis of such assets in the hands of Aetna Casualty immediately prior to the transfer (section 362(b)).

(6) Pursuant to section 354(a), no gain or loss will be recognized to the shareholders of Aetna Casualty upon the exchange of the Aetna Casualty stock for the voting stock of Aetna Life (including fractional shares to which they may be entitled).

(7) The basis of the Aetna Life stock (including fractional shares) received by the Aetna Casualty shareholders will be the same as the Federal income tax basis of the Aetna Casualty stock surrendered therefor immediately prior to the exchange (section 358(a)). The holding period of the Aetna Life stock (including fractional shares) will include the holding period of the Aetna Casualty stock surrendered therefor (section 1223(1)).

(8) Where fractional shares are purchased to create a whole share, the basis of such a share will be the basis of the fractional interest owned by the shareholder plus the

cash paid to buy additional fractions necessary to acquire a full share. Such share will have a split holding period. That part of the share which is attributable to the fractional share received as a result of the exchange will include the holding period of the stock surrendered therefor. That part of the share which is attributable to fractional interests purchased will have a holding period beginning with the date following the date of the acquisition.

(9) The transfer of the New stock by Aetna Life to a trustee for the benefit of the shareholders of Aetna Life pursuant to the transaction described above will constitute a distribution within the meaning of section 355 of the Code. No gain or loss will be recognized to Aetna Life or its shareholders as a result of the distribution (sections 311 and 355).

(10) Pursuant to section 358 of the Code and section 1.358-2 of the Regulations, the basis of the stock of Aetna Life will be allocated between such stock and the stock of New received, in proportion to the fair market value of each on the date of the distribution. As provided in section 1223(1) of the Code, the holding period of the New stock received will include the period for which the Aetna Life stock was held.

(11) Where cash is received by a shareholder as a result of the sale of a fractional share of Aetna Life stock, gain or loss will be recognized measured by the difference between the basis of the stock upon which the stock split and stock dividend were made (or the stock surrendered for such fractional interest), properly allocated

to the fractional share sold, and the amount received. Provided such interest is a capital asset in the hands of the shareholder, the gain or loss will constitute a capital gain or loss subject to the provisions and limitations of Subchapter P of Chapter 1 of the Code.

(12) The transfer of the New stock by Aetna Life to a trustee for the benefit of its shareholders will not constitute a distribution within the meaning of section 815, except to the extent the following rule provided in section 815(f) applies:

> Paragraph (3) shall not apply to that portion of the distribution of stock of the controlled corporation equal to the increase in the aggregate adjusted basis of such stock after December 31, 1957, except to the extent such increase results from an acquisition of stock in the controlled corporation in a transaction described in subparagraph (B) of such paragraph. If any part of the increase in the aggregate adjusted basis of stock of the controlled corporation after December 31, 1957, results from the transfer (other than as part of a transaction described in paragraph (3)(B)) by the distributing corporation to the controlled corporation of property which has a fair market value in excess of its adjusted basis at the time of the transfer, paragraph (3) also shall not apply to that portion of the distribution equal to such excess.

It is important that a copy of this letter be attached to the Federal income tax returns of the corporations involved for the taxable year in which the transactions are consummated.

Very truly yours,

John W. S. Littleton

Director, Tax Rulings Division

THE ÆTNA CASUALTY AND SURETY COMPANY

HARTFORD, CONNECTICUT

October 26, 1964

To the Shareholders:

You will find enclosed a Notice of Special Meeting of Shareholders of The Ætna Casualty and Surety Company to be held November 24, 1964 and a Proxy Statement in respect to this meeting and a meeting of the shareholders of Ætna Life Insurance Company to be held the same day. A Proxy card for your use is inserted in the small envelope attached to this mailing.

The Plan of Merger which will be presented to the meeting is part of a plan of reorganization described in detail in the attached Proxy Statement. Under the plan, Ætna Casualty shareholders will receive 1.9 shares of Ætna Life for each share of Ætna Casualty (equivalent to .76 of a share of Ætna Life before a proposed Ætna Life 2-for-1 stock split and 25% stock dividend) and Ætna Casualty will be merged into a new wholly-owned subsidiary of Ætna Life.

The Connecticut Insurance Commissioner has approved the proposed plan, including the ratio of 1.9 Ætna Life shares to be received for each share of Ætna Casualty, as fair to the shareholders of each Company. The ratio was recommended by the investment firm of Morgan Stanley & Co. and Alfred M. Best Company, Inc., insurance finance experts, who were retained by the Boards of Directors of the Companies to advise them in respect to these proposals.

The ratio of 1.9 Ætna Life shares for each Ætna Casualty share represents a premium to Ætna Casualty shareholders, based on relative market prices on August 27, a week prior to the announcement of the proposed plan, of about 15%.

The proposed reorganization will be tax-free for federal income tax purposes (except for taxes payable on the sale of a fractional interest in a share of Ætna Life received in the merger or on amounts received on the exercise of statutory appraisal rights).

The Boards of Directors of Ætna Casualty and Ætna Life have indicated their intention, if the plan of reorganization is adopted by the shareholders and assuming a continuation of satisfactory earnings, of declaring for payment on January 15, 1965 an aggregate quarterly cash dividend on the shares of the two Companies of 20¢. This is equivalent to an annual cash dividend rate on the present Ætna Casualty shares of $1.52, compared to the $1.60 current rate.

It is expected that Ætna Life stock certificates will be mailed to Ætna Casualty shareholders beginning on or about January 8, 1965 upon surrender of their Ætna Casualty stock certificates.

Adoption of the plan of reorganization requires approval of the Plan of Merger by holders of not less than two-thirds of the outstanding shares of Ætna Casualty. For that reason, you are urged to sign and return the accompanying Proxy card promptly.

Olcott D. Smith

OLCOTT D. SMITH
Chairman

John A. Hill

JOHN A. HILL
President

TRUST AGREEMENT made in Hartford, Connecticut, by and between ÆTNA LIFE INSURANCE COMPANY, a corporation organized and existing under the laws of the State of Connecticut (hereinafter called "Ætna Life") as Settlor, and HARTFORD NATIONAL BANK AND TRUST COMPANY, a national banking association organized and existing under the laws of the United States of America (hereinafter called the "Trustee") as Trustee.

Ætna Life hereby transfers and assigns to the Trustee and the Trustee hereby acknowledges receipt of shares of the common stock $25.000 par value per share of THE ÆTNA CASUALTY AND SURETY COMPANY (hereinafter called "Ætna Casualty"). The Trustee agrees to hold such shares, all additional shares of such stock hereafter acquired by or delivered to it, and any and all other property received on any sale or exchange thereof (hereinafter called the "Trust Property"), IN TRUST, and administer and distribute the Trust Property and all income and proceeds therefrom in accordance with all the terms and provisions of this Trust Agreement.

FIRST: *Name of Trust.*

The Trust hereby created shall be known as "THE ÆTNA CASUALTY AND SURETY COMPANY STOCK TRUST", and is hereinafter referred to as the "Trust".

SECOND: *Definitions.*

As used in this Trust Agreement:

A. The word "Trustee" shall mean the Trustee hereinabove named and any successor Trustee serving hereunder from time to time.

B. The words "Beneficiary" and "Beneficiaries" shall mean, respectively, a holder of record and the holders of record, from time to time, of Ætna Life Stock as hereinafter defined.

C. The words "Ætna Casualty Stock" shall mean the common stock of Ætna Casualty issued and outstanding from time to time.

D. The words "Ætna Life Stock" shall mean the shares of common capital stock of Ætna Life issued and outstanding at the close of business on the date of this Trust Agreement and all shares of common capital stock of Ætna Life thereafter issued in any distribution representing a stock split, stock dividend or other distribution on such stock or on any stock so issued, or as a result of any reclassification thereof.

E. The words "this Trust Agreement" shall mean the within Trust Agreement and any and all amendments thereto made in accordance with the provisions of Article Eighth of this Trust Agreement.

THIRD: *Beneficiaries' Interest in the Trust.*

The beneficial interest of each Beneficiary in the Ætna Casualty Stock held in the Trust and in other Trust Property at any time shall be in the same proportion to the aggregate of the beneficial interests of all Beneficiaries as the number of shares of Ætna Life Stock held of record by such Beneficiary bears to the then aggregate number of shares of Ætna Life Stock.

FOURTH: *Transferability of Beneficiaries' Interest.*

The beneficial interest of a Beneficiary shall be transferable only in conjunction with the transfer of such Beneficiary's Ætna Life Stock; and every transfer of shares of Ætna Life Stock by a Beneficiary shall be deemed to include, and shall include, the beneficial interest of such Beneficiary in the Ætna

Casualty Stock held ... the Trust and in other Trust Property, which relates to the Ætna Life Stock so sold or transferred, whether or not any legend descriptive of such beneficial interest has been affixed to or imprinted on the certificate representing such share or shares of Ætna Life Stock.

FIFTH: *Distribution of Dividends and Retention of Stock Dividends and Stock Splits.*

A. Subject to the payment of the Trustee's expenses and compensation, as set forth in Section C of Article Twelfth hereof, all dividends and other distributions, except distributions representing stock splits, stock dividends or other distributions of Ætna Casualty Stock, at any time paid upon or with respect to the shares of Ætna Casualty Stock held in the Trust shall be paid over promptly by the Trustee to those persons who were Beneficiaries as of the record date designated by Ætna Casualty for the determination of shareholders entitled to receive such dividend or other distribution, and in accordance with their then respective beneficial interests in the Ætna Casualty Stock held in the Trust.

B. The Trustee may discharge its obligation to make payment of any such dividend or other distribution of Ætna Casualty by:

(i) paying such dividend or other distribution to a bank or trust company (including Hartford National Bank and Trust Company), as disbursing agent, for the account of the Beneficiaries; or

(ii) otherwise causing such payment to be made to the Beneficiaries.

C. Subject to the provisions of Article Seventh hereof, any and all shares of Ætna Casualty Stock which may be paid or issued to the Trustee as a stock split, stock dividend or other distribution shall be added by the Trustee to the Ætna Casualty Stock then held in the Trust.

SIXTH: *Voting Rights as to Ætna Casualty Stock Held in the Trust.*

A. Upon receipt by the Trustee of notice of any meeting of the shareholders of Ætna Casualty, the Trustee shall promptly send or cause to be sent to each person who was a Beneficiary on the record date designated by Ætna Casualty for the determination of shareholders entitled to vote at such meeting, at the address then shown for such Beneficiary as a shareholder of Ætna Life on the stock record books of Ætna Life, a written notice of the matters to be acted upon at such meeting, as specified in the notice thereof. Such notice to each Beneficiary shall be accompanied by a written form, which the Beneficiary may return to the Trustee prior to the meeting, on which the Beneficiary may instruct the Trustee how to vote with respect to that percentage of the Ætna Casualty Stock which corresponds to the percentage of the Ætna Life Stock held of record by such Beneficiary on the record date for such vote. The Trustee shall vote the Ætna Casualty Stock held in the Trust in accordance with the Beneficiaries' instructions.

B. The Trustee shall have no power to vote any portion of the Ætna Casualty Stock with respect to which it has not received written instructions in accordance with the provisions of this Article.

SEVENTH: *Preemptive Stock Rights.*

If at any time Ætna Casualty shall increase its capital by offering new stock for cash, any preemptive rights to such new stock then existing with respect to the Ætna Casualty Stock held in the Trust shall inure ratably to the Beneficiaries. The Trustee shall notify the Beneficiaries or cause them to be notified of their respective preemptive rights with regard to any such offering and shall act as agent for the Beneficiaries, pursuant to their instructions, in exercising such rights. Shares purchased by a Beneficiary in the exercise of his preemptive rights in accordance with the provisions of this Article shall be issued in the name of such Beneficiary and delivered to him free of the Trust.

EIGHTH: *Power of Beneficiaries to Amend this Trust Agreement and to Terminate the Trust.*

A. Subject to the provisions of Section B of this Article, the Beneficiaries shall have the power, at any time or times, by vote of not less than two-thirds in interest, to amend this Trust Agreement or to terminate the Trust.

B. The unanimous vote of the Beneficiaries shall be required for any amendment to this Trust Agreement which either (i) affects the right of a Beneficiary to instruct the Trustee as to voting shares of Ætna Casualty Stock, or (ii) changes the vote of Beneficiaries required for amending this Trust Agreement or terminating the Trust.

C. Upon the termination of the Trust, whether pursuant to a vote of the Beneficiaries in accordance with the provisions of this Article, or pursuant to the provisions of Article Ninth hereof, the Trustee shall, as soon as practicable, distribute the Ætna Casualty Stock and other Trust Property then held by it to the Beneficiaries in accordance with their interests therein, and to that end is hereby empowered to take all such action (including the voting of Ætna Casualty Stock or any other securities) as may, in its judgment, be necessary to permit and carry out such distribution.

D. If the Trustee, in its discretion, shall determine that a vote of the Beneficiaries should be taken, or upon the written request of either ten percent (10%) in interest of the Beneficiaries or the Board of Directors of Ætna Casualty, the Trustee shall promptly call a meeting of Beneficiaries at which their vote may be taken. The Trustee may fix a date as the record date for determining Beneficiaries entitled to notice of and to vote at such meeting, such date to be not earlier than seventy days and not later than ten days before the date of the meeting. The Trustee shall give written notice of such meeting, and of the matters to be voted upon, to each Beneficiary entitled to vote, at the address shown for such Beneficiary as a shareholder of Ætna Life on the stock record books of Ætna Life as of the record date fixed by the Trustee. Such notice shall be accompanied by a written form which the Beneficiary may return to the Trustee prior to the meeting, on which the Beneficiary may indicate his vote with respect to each such matter. Any Beneficiary who has not returned such form or who has revoked the same may vote in person or by proxy at any such meeting. The Trustee may make rules and regulations respecting any such meeting and any adjournment and reconvening thereof as it, in its discretion, shall determine.

E. Except where a unanimous vote is required under the provisions of Section B of this Article, and subject to the provisions of Section H of Article Twelfth hereof, the affirmative vote of not less than two-thirds in interest of the Beneficiaries on any amendment or on termination of the Trust, shall be binding on all Beneficiaries and on the parties to this Trust Agreement. The Trustee shall not be liable or accountable to any person for any act done in accordance with any such affirmative vote.

NINTH: *Duration of the Trust.*

Unless earlier terminated by action of the Beneficiaries pursuant to the provisions of Article Eighth of this Trust Agreement, the Trust shall terminate twenty-one (21) years after the death of the last survivor of all the descendants born on or before the date of this Trust Agreement of
late of West Hartford, Connecticut, who died on or about

TENTH: *Sale or Exchange of Ætna Casualty Stock.*

The Trustee shall have the power, but only with the affirmative vote of not less than two-thirds in interest of the Beneficiaries, obtained in accordance with the procedure outlined in Article Eighth of this Trust Agreement, at any time or times, to sell, exchange or otherwise dispose of part, parts or all of the Ætna Casualty Stock held in the Trust.

ELEVENTH: *Employment of Agents, Attorneys and Accountants.*

The Trustee shall have the power to employ such agents, attorneys and accountants as it, in its discretion, shall determine, to aid it in the performance of its duties hereunder, and may allow and pay to such agents, attorneys and accountants reasonable compensation plus costs and disbursements.

TWELFTH: *Concerning the Trustee.*

A. At any time that the Trustee shall reasonably require (i) access to the stock record books of Ætna Life, or (ii) a list of holders of record of Ætna Life Stock as of any record date, the Trustee shall have such access or Ætna Life shall provide such list, as the case may be.

B. At any time that the Trustee shall request certification of any action taken by Ætna Life pursuant to the Trustee's request in discharge of the Trustee's obligation to cause any action to be taken under this Trust Agreement, Ætna Life shall furnish such certification.

C. The Trustee shall be entitled to rely upon stock record books and lists of shareholders and certifications provided by Ætna Life or Ætna Casualty, from time to time.

D. The Trustee may resign at any time by giving written notice of resignation to the Beneficiaries. Such notice of resignation shall specify the date as of which such resignation shall become effective, which, in no case, shall be earlier than one hundred twenty days after the giving of such notice to the Beneficiaries. The Beneficiaries may remove the Trustee at any time by the affirmative vote of a majority in interest of the Beneficiaries, obtained in accordance with the procedure outlined in Article Eighth of this Trust Agreement.

E. If the Trustee shall take part in any merger, consolidation or other change in corporate form, the corporation resulting from such merger, consolidation or other change, or the corporation succeeding to the largest part of the fiduciary business of the Trustee, shall be the successor Trustee hereunder.

F. Upon the resignation, removal or dissolution of the Trustee, the Beneficiaries are empowered to appoint a successor Trustee by the affirmative vote of a majority in interest of the Beneficiaries, obtained in accordance with the procedure outlined in Article Eighth of this Trust Agreement. Any successor Trustee serving hereunder shall have all the powers, discretion, immunities and privileges of the Trustee hereinabove named.

G. The Trustee shall be entitled to reasonable compensation for its services as Trustee hereunder. Such compensation, and all expenses incurred by the Trustee, may, unless other provision is made for payment, be charged against and deducted from the cash dividends of Ætna Casualty otherwise payable to the Beneficiaries or from other income; but the Trustee shall in no event be obliged to take any action requiring expenditure of its own moneys unless there shall first be adequate assurance of reimbursement for such expenditure.

H. No amendment of this Trust Agreement which increases or enlarges the duties of the Trustee or any of them shall be binding upon it unless it shall first have agreed in writing to such amendment.

THIRTEENTH: *Governing Law.*

This Trust Agreement and the Trust shall be governed and construed in all respects under the laws of the State of Connecticut.

IN WITNESS WHEREOF, the parties have executed this Trust Agreement at Hartford, Connecticut, this day of December, 1961.

UNITED STATES GOVERNMENT

Memorandum

TO : District Director
Hartford, Connecticut

DATE: AUG 29 1968

FROM : National Office
Internal Revenue Service

SUBJECT: Request for Technical Advice

In re: The Aetna Casualty and Surety Company

Taxable Years: 1965 and 1965

This is in response to your memorandum of May 14, 1968, requesting technical advice.

Facts

In a ruling letter dated October 23, 1964, this office ruled as to the Federal income tax consequences of a proposed transaction involving Aetna Life Insurance Company ("Aetna Life"), The Aetna Casualty and Surety Company ("Aetna Casualty"), and a new corporation ("Newco"). Prior to the transaction, Aetna Life owned 62.04 percent of Aetna Casualty. Newco, a wholly owned subsidiary of Aetna Life, had been organized by Aetna Life to acquire the assets of Aetna Casualty.

Briefly, the ruling letter of October 23, 1964, discussed the income tax consequences of a transfer of all the assets of Aetna Casualty to Newco in exchange for stock of Aetna Life. Following the acquisition of the assets of Aetna Casualty by Newco, Aetna Life distributed all of the stock of Newco to a trust for the benefit of the Aetna Life shareholders. The transactions were consummated on December 29, 1964.

Since December 29, 1964, Newco has incurred losses of approximately $47,730,000.

Issue

The question presented for technical advice is whether the losses incurred by Newco since the consummation of the transaction may be carried back to a taxable year of Aetna Casualty pursuant to the provisions of section 381(b) of the Internal Revenue Code of 1954.

Discussion

Our prior ruling letter held that the above described acquisition of the assets of Aetna Casualty by Newco constituted a reorganization within the meaning of section 368(a)(1)(C) of the Code. Representatives of the corporations now contend that the reorganization also qualified under section 368(a)(1)(F).

A section 368(a)(1)(F) reorganization is "a mere change in identity, form, or place of organization however effected." In the case of a reorganization qualifying under section 368(a)(1)(F) (whether or not such organization also qualifies under any other provision of section 368(a)(1)), a net operating loss of the acquiring corporation may be carried back in accordance with section 172(b) to a prior taxable year of the acquired corporation (section 1.381(b)-1(a)(2) of the Income Tax Regulations). However in a section 368(a)(1)(F) reorganization, there must be a transfer of property to which section 361 applies in order for 381(b) to be applicable (See section 381(a)(2)).

Section 368(b) of the Code provides that in the case of a reorganization qualifying under paragraph (1)(B) or (1)(C) of section 368(a) of the Code, if the stock exchanged for the stock or properties is stock of a corporation which is in control of the acquiring corporation, the term "a party to a reorganization" includes the corporation so controlling the acquiring corporation. Section 368(b) of the Code does not include, however, as a party to a reorganization a corporation which is in control of the acquiring corporation in a reorganization under section 368(a)(1)(F).

If the transaction were to be treated as an (F) reorganization section 361 would not apply to the transfer of property by Aetna Casualty to Newco since Aetna Life is not "a party to a reorganization" under section 368(b) of the Code. (See Revenue Ruling 67-326, C.B. 1967-2, 143). Accordingly, since section 361 of the Code would not be applicable if the reorganization did qualify, as claimed, under section 368(a)(1)(F), section 381(b) of the Code could not apply insofar as that section allows the acquiring corporation to carry back its net operating loss to a taxable year of the transferor ending before the date of transfer.

Conclusion

Since the transfer of property by Aetna Casualty to Newco in exchange for the stock of Aetna Life does not meet the requirements of section 361 in a section 368(a)(1)(F) reorganization, net operating losses of Newco may not be carried back in computing the taxable income of Aetna Casualty for a taxable year ending before the date of transfer.

-- END --

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF CONNECTICUT

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THE AETNA CASUALTY & SURETY COMPANY	:	
Plaintiff	:	
vs.	:	Civil Action No. H-131
UNITED STATES OF AMERICA	:	
Defendant	:	

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Deposition of STEPHEN B. MIDDLEBROOK taken pursuant to Rule 28 of the Federal Rules of Civil Procedure, at the Law Department of the Aetna Casualty & Surety Company, 151 Farmington Avenue, Hartford, Connecticut, before Bonita Cohen, a Notary Public in and for the State of Connecticut, on Friday, October 11, 1974 at 9:30 A.M.

then President of Aetna -- I'm sorry -- Smith was then Chairman of Aetna; John A. Hill was President; Henry S. Beers was Director; John M. Meyer, Jr. was a Director; William B. Johnson was a Director; John P. Miller was a Director. That was the committee.

Q Now, you stated that you first became aware of this reorganization when Mr. Filer, more or less your boss, came to you and asked you to do some investigation.

A Yes. He told me that I would be involved in it and he and I were the internal lawyers principally involved in it, yes.

Q Okay. Do you recall what the general terms of the reorganization were?

A You mean as they finally emerged after the planning process?

Q Yes.

A Yes, I do.

Q Okay. I ask that question only. I was going to let you go through it, if you didn't have a recollection at this time. I just asked you that for future questions later to give you time to review these things if you wanted to.

Do you know why the reorganization was contemplated?

A I think for a number of years there had been a concern at Aetna about the lack of identity between the shareholders of

Aetna Life Insurance Company and the shareholders of the Aetna Casualty & Surety Company.

Aetna Life was a 68 percent owner of Aetna Casualty, but there was a rather substantial minority interest and, yet, the two companies were occupying the same building, had similar officers, had identical directors and, in many respects, were trying to pursue an image of an all-purposes-multi-line insurance operation.

Periodically, there was frustration experienced because in planning decisions that were for the good of the entire organization, multi-line organization, one or two or three people would point out that a particular decision might, nevertheless, not be of benefit for an individual company in that organization-- usually Aetna Casualty, sometimes Aetna Life -- and because there was not an identity of shareholding interests, there was some concern as to how far we could go in implementing a decision, though it was for the good of the organization.

In a decision, Aetna Casualty, as a large holding in the Aetna Life portfolio, created what appeared to be an adverse aberrational tax result in that it was a low-yielding and yet high-valued security, and under the Life Insurance Income Tax Act that created an adverse tax result to Aetna Life Insurance Company-

will support that agent, carrying him, if you will, through the early years when he's not making much commision income, in return for which that commission income will be returned in later years. It is not completely an employer-employee relationship, but it is a much closer relationship than the principal agent relationship in the sense that there's a good deal of carrying and feeding going on between the life insurance company and the agent.

Q Okay. I interrupted your explanation. I don't know if you had any more to say on the operational relationships between the two.

A Wherever, I think it is fair to say, that in most cases, wherever the two companies had common needs, such as the purchase of furniture, for example, or the solving of legal problems, the employees were identical for both companies. The only times you found different employees were in those areas where the needs were not the same.

For example, underwriting, actuarial services where at lower and mid management levels you did have people working exclusively for the Casualty company and people working exclusively for the Life company with regard to those skills that are unique for either of the two companies.

From a staff standpoint, there was an almost complete

identity and from a top managerial standpoint there was almost a complete identity. In fact, I think it is fair to say, and I think I have said that all senior officers of the Life companies were also senior officers of the Casualty company.

Q Now, after the reorganization took place, can you recall any change whatsoever in the operational aspect of the relationship between the two companies?

A. Well, we're talking about a reorganization which took place in December of '64. It is now almost ten years. There certainly have been some changes over the ten-year period. The day after the reorganization took place there were none. Ten years later there have been several.

Q There were no changes in the operational relationships that were a result of the reoganization?

A. I think that's right. The reoganization itself effected no organizational changes. It did make possible some changes in operations that were being contemplated and over the course of ten years we've been able to implement some changes in the business and in the operations that might have been more difficult to do had we not secured an identity of shareholder interests.

Q Can you recall what these changes were?

A. Yes. I'd like to consult some notes, if I may.

Q Sure.

A And in some of these areas, I'm not going to be able to give you a precise time indicator without checking some more documents but, for example, before the reoganization took place Aetna Life and Aetna Casualty were both chartered to write and did in fact write accident and health insurance business. The Life insurance company did a great deal more than the Casualty.

After the reorganization, there was no longer any need for the Casualty company to -- well, I should revise that. It was thought to be inefficient to have both companies writing the same product and eventually, over a period of time, virtually all of the Casualty companies, accident and health writings were transferred to Aetna Life so that today all of the Aetna accident and health business group and individual is done by Aetna Life Insurance Company and sold by its agents.

Q May I ask you a question on that one now.

Why couldn't you have done that before the reorganizatio

A Well, we could have and to some extent did, but the concern that we had was to the extent that this is a profitable business and for the good of the organization we decided to take it out of Aetna Casualty and put it all in Aetna Life. We have to worry about whether that is going to be the kind of decision

that a minority shareholder can attack as being against his interest. Once you eliminate that minority shareholding position, that argument goes away and that's what happened in '64.

Similarly, talking about operations, we used to have a very elaborate cost allocation system. I've referred to many areas where there were their identical employees performing functions for Aetna Casualty and Aetna Life and that constantly meant that somebody would have to sit back and figure out elaborate cost allocation methods to assign Aetna Life its fair share and Aetna Casualty its fair share.

Now, there is still a need to do that in a very general way to promote general fairness because the insurance laws require it and principles of equity require it and in order to get fair rates for our policyholders it is required, but we no longer have to worry about a shareholders' suit based on the premise that we have stuck Aetna Casualty or Aetna Life, depending on whose company you hold shares in, with a very unfair burden of the costs that both companies are assuming. So, our cost allocation in terms of time spent worrying about it, arguments between Casualty people and Life people has become very much less? a problem to us since 1964 than it did before 1964.

Q Did you -- correct me if I'm wrong -- did I understand

you to say that you made some transfers of the accident and health business to the Life company prior to the reorganization?

A. I think I did say that over a period of time we had come to write most of the accident and health business in Aetna Life Insurance Company, even though both companies were chartered. I can't give you volume or figures but there was always a nervousness about decisions like that. We had also, for example, just to put this in a proper context, we had claimsmen working for Aetna Casualty who would handle accident and health claims for Aetna Life Insurance Company. That's generally regarded as a casualty insurance coverage, so a casualty claimsman has some expertise. Aetna Casualty would charge Aetna Life for rendering the service at a cost. That made us somewhat nervous because it could have been argued conceivably by a minority shareholder that Aetna Life should be getting a fair return above cost for rendering this service.

In addition, in the group accident and health area, where claims handling is a more complicated process than for other casualty lines, we tended to want our better people, the people that were proving themselves in the organization, to switch from perhaps other casualty lines to handle this kind of a casualty line i.e., the kind that benefited the Life company. We worried

about whether a minority shareholder might have a complaint that the better people in the organization were being siphoned off, if you will, for the good of this company in which they owned no stock.

So, these things were in transition before '64 but were causing us concern and worry about whether we were being properly fair to the minority group. Once that minority group was eliminated, those concerns went away and we were able to make decisionslike this solely with concern as to whether it made sense for the organization, not with concern as to whether it was prejudicing some shareholding group.

Q Do you recall of your own personal knowledge or if someone told you of any actual challenges by Casualty shareholders to what the Life company was doing in transferring this accident and health business?

A No, I don't recall any such threatening litigation.

Q So, you were concerned at this point with just potential conflicts.

A Yes.

Q All right. Are there other changes that you wanted to enumerate?

A The Aetna Life Company wrote a line of business called

Group Disability Insurance. Essentially, it provided that in the case of non-job related injury or illness, you would be compensated a certain amount of dollars per week or months or for as long as you were prevented from working and the Aetna Casualty Company wrote Workmen's Compensation insurance which covers the revise of the situation I've just indicated in the case of occupational-related injury or disease and these policies provided payments for a period of time while you were out of work.

It is logical, if it can possibly be done, for both of these coverages to be written in one policy or by one company.

Our charts and the State licensing laws prevent either of those alternatives. The next best alternative is to have your group disability company and your group workmen's compensation company, i.e., Aetna Life and Aetna Casualty write and administer jointly the group disability and workmen's compensation coverage for the same customer.

You can see it. I think it is almost self-evident that there are savings involved if one organization is performing the entire underwriting function for a single customer. We did not feel comfortable about doing that before '64 because again, we did not have a common shareholder and there are problems of whether you are penalizing one company again for the good of the

organization.

After '64 we did experiement with this kind of coverage and did in fact write it in a number of instances.

In fairness, and in the interest of completeness, I'd have to say in retrospect that there were legal problems having nothing to do with minority shareholder problems that led us to abandon that particular approach to selling group disability coverage and we now treat them as two distinct coverages that have to be accounted for separately but for a while we thought we could and did in fact write the coverages jointly for a number of customers, something that we would not have been able to do or would have been uncomfortable about doing before '64.

Malpractice insurance, I think, would be another example of what we felt more free about doing after 1964 than before. When I say "malpractice" I mean medical malpractice insurance covering liability of doctors for not performing their trade or performing their trade or profession negligently. It is a very tough insurance coverage to write. It is riddled with high risk and unpredictability and by itself it is not a very attractive insurance coverage. The Casualty company was equipped to write malpractice insurance. Meanwhile, the Life insurance company was developing a variety of very attractive coverages for

professional people such as doctors, deferred compensation plans funded by insurance, straight life insurance, group accident and health insurance for small groups of people, small groups of doctors, their nurses, their staff. We could see as an organization merit and being able to offer a package of coverages which included this attractive coverage I've just mentioned, life insurance, and had thrown in, if you will, malpractice insurance. The package made sense even though the individual component of malpractice, when looked at from the casualty standpoint, may not have made sense. Here again with a minority shareholder interest to worry about, we found it difficult to justify that coverage on an accommodation basis. Writing that coverage solely because the Life company was writing life insurance coverage for the same group of doctors, once we had a single organization concept, we found that we could indeed comfortably write both pieces because overall it was profitable to the organization, even though Aetna Casualty had only marginal and in some years no profits from this particular kind of business for this particular clientele.

One of the things that we had tried to install in our senior and mid level management people was to think in terms of the overall Aetna organization in implementing and in dividing and implementing business and selling plans. That had been very

unsuccessful before 1964 because it was extremely difficult to translate incentive into reward. For a number of years, because of the division of the two companies, certainly the managers ranging up at least to the mid level had been encouraged to think solely in terms of their own company and to promote plans, devise, implement ideas that would benefit their company, be it Aetna Life or Aetna Casualty. One way you tend to encourage broader-based thinking, total-organization thinking is to devise a bonus or an incentive plan which rewards those ideas that produce bottom-line profits to the whole organization even though their affect on the individual company is marginal or even negative.

Once again, it's difficult to put that kind of bonus plan into effect when you have a minority shareholding group outstanding. Once you have an identity of interest of shareholding groups, you can present to your shareholders with some comfort a plan which tends to award contributes to the whole organization.

We now have such a plan called the Management Incentive Plan which rewards efforts that produces good to the overall organization. We also have a plan called the Performance Bonus Plan which does the same thing at a lower level in the organization.

These changes came well after '64.

I can also cite the case of at least one senior officer

A. I certainly wouldn't want to say they were all inclusive. I am sure there are other modest ones not mentioned here. These would be the ones that would occur to me firsthand if I were to, and I think some of your questions are similar to the one you're asking me now, and I think the testimony I've given mentions many of these things. To the extent I did mention others, sure, those would be other examples, but other than those that I have mentioned, other than these offhand, I think it's a pretty good list of the major benefits that were derived from the integration, yes.

Q. Would it be fair to say then that most of the business benefits that resulted from the integration were related to the operational aspects of the company more than decision-making. I know it's very difficult to exclude it, I guess.

Would it be fair to say that the integration of the two prevented duplication of effort and cost?

A. Well, I think that's self-evident from these examples, yes, by not having to have two home offices which, having people who could perform on one day Aetna Life functions and on the other day Aetna Casualty without having people being switched as to to where the need arose. Sure, that was a benefit of real value.

Q. And the fact that the Aetna Life Company owned approximate

62 percent of the Casualty company stock, would you consider that a business benefit in the sense that they owned majority control of the Casualty company and they could dictate decisions, is that not correct?

A. To the extent they didn't have to worry about fiduciary responsibility to the minority, yes. I think it was of advantage to Aetna Life to be able to project a multi-line image. It was an advantage to Aetna Casualty to be able to project a multi-line image. The organization benefited by being able to be perceived in the public mind as a multi-line organization whereby dealing with the same people you could get virtually all of your insurance needs taken care of.

To put it another way, if each company could trade to some extent off the reputation and prestige of the other, if you'd be doing business with Aetna Casualty for a number of years and were seeking life insurance projection, you would be inclined to look favorably to Aetna Life, if you had had a good experience with Aetna Casualty. The reverse is true.

Q. Prior to the reorganization?

A. That perhaps really isn't mentioned here. I think the image of a multi-line company and the ability of each company to trade to a certain extent off the goodwill of the other is a

certain real advantage.

Q Before the reorganization, was it your feeling that the public identified Aetna Casualty with Aetna Life?

A It certainly did. I think it has come to do so more after the reorganization, substantially more because of some agencies that we've taken, but certainly before '64, sure. The public tends to regard the two companies together. It was complicated a bit by the fact that there is yet another Aetna Insurance Company in town, not owned by Aetna Life, but more recently owned by CG and originally an independent company which sold coverage very similar to Aetna Casualty, so there was always that confusion. It's a confusion that I think is tended to dissipate by the fact that we can advertise Aetna Life and Aetna Casualty together. We do advertise it together now under a logo which refers to Aetna Life & Casualty and I think over the years the other Aetna has become much more associated as a Connecticut general company.

Q Prior to the reorganization, can you recall the type of letterhead that Aetna Life had?

A I suspect we had several letterheads.

Q Specifically.

A For shareholders, for example, we used separate

hundred percent owned rather than 62 percent owned, if I can't consider the question as phrased, the elimination of the minority interest in Aetna, and the fiduciary duty that went along with it.

Q Well, getting back to the practical effects, I guess, considering all factors, what affect did the one hundred percent acquisition have in allowing you to accomplish this full line of insurance goal?

A I can now consider the minority again?

Q You can consider anything you want from the practical plus the legal aspects.

A Again I would refer to my previous testimony which mentions some lines of insurance which we would have been uncomfortable writing in Aetna Casualty if we had to worry about the minority shareholders who might criticize us for writing lines or types of business which were not sufficiently profitable. Without the minority interest, that was no longer.

What I was referring to there, generally lumped under the heading Accommodation Business, one company accommodates another for the good of the organization. Some of the things that were going through our minds were, for example, in the field of aviation insurance. Life insurance writers covered the death risk and the accident disability risk from large aviation disasters.

Casualty underwriters covered the plane, the haul insurance. We saw attractive possibilities of being able to write those coverages jointly even though in some instances it might not make sense for a single company to write a single line of coverage by itself.

Another example. I don't think I did give this to you before. We had a great many, very valuable life insurance producers, people who brought to us continually highly profitable life insurance coverage. Some of these people, even though their prime business is selling life insurance, also are in the casualty and property insurance business. Ordinarily some of the casualty and property coverages they might bring us would be very marginal or perhaps even below our normal underwriting standards. There were No insurance regulartory problems in writing them but if, given our choice, we would prefer not to. On the other hand, it was possible having eliminated the minority interest to look at these producers from an organizational standpoint and to say, well, we will keep this person in our organization producing the valuable life insurance business he has been producing, we will write some of the casualty coverages that he brings to me that we might not otherwise write if there weren't that relationship. We use the same technique with a young life insurance producer. In the early

years in the life insurance business it is hard to make much of a dollar. I have indicated before that the Life company has to give backup financial support to get you through those early years because you're doing a lot of education and training. You're on a commission-type of salary and -- excuse me -- commissioner type of income and it takes a while to get going.

One way to keep these people in, to give them adequate grocery money, is to take from them on the side, if you will, casualty and property insurance lines that they may be writing in their spare time. Again, if they weren't related to us in the Life insurance connection, it might not be the kind of business we would ordinarily take, not always because it was lousy business but sometimes because it was so small that the administrative expenses and effort involved in putting it on our books would not justify the profitability, but for the fact that we had a relationship with that life insurance producer that made it worth our while to find out ways to compensate.

Q But you could have accomplished it or followed the trend towards full-line insurance without going through this reorganization; there was nothing really to stop you, was there?

A I don't think we could have comfortably written what I've been referring to as accommodating business or as comfortably

written that business had we not gone into a single identity of sharholding interest because we had to constantly worry that the minority shareholder was not able to benefit from the bottom line organizational profit of doing that accommodation business and we've been focusing entirely on the minority of Aetna Casualty and I think it is fair to look at it from another side. There were conceivably some areas of business that made great sense for Aetna Casualty but might not have made much sense for Aetna Life Insurance Company to write. The reverse of the situation I was just describing. A very valuable Casualty producer for the Casualty company brings marginal life or accident, health business. Well, we would consider placing it in Aetna Life but now we would have the Aetna Life shareholder to worry about if he doesn't fully share the benefits to Aetna Casualty. It was less of a problem because we would share 62 percent of the benefits, but the problem did exist on the other side.

Your questions have been pointed in the insurance underwriting vain and I don't know whether it is relevant to that form of question but I should point out that we haven't been focusing at all on the financial structure of the company.

In the Casualty business in particular it is extremely important to the insurance regulator to know what the relationship

of your premium writings are to your surplus, a very general rule of thumb, and each regulator has his own.

If you are writing more than four times your surplus, for example, if you are writing a billion dollars of premium and your surplus is only $200 million, you are approaching a danger point in terms of an insolvency risk where you might find that to make good on all of your risks and to properly book all of your liabilities, you are seriously invading your surplus, of course, as perceived by a regulator as a buffer between your day-to-day liabilities and exposures and your ultimate exposures.

If we perceive of two companies in a 62 percentage relationship rather than 100 percent relationship, it becomes very difficult to justify a transfer, if you will, from the parent company, in this case Aetna Life, of a large amount of surplus to the Casualty company in order to shore up its surplus position so that the premium surplus ratio gets better, so that the Casualty company can continue to write more business. In the 100 percent relationship it becomes easier to justify that.

The same analysis holds true of dividends, particularly if you're dealing with two businesses which are not always functioning in direct relationship to the other.

I've mentioned that the Casualty business is cyclical

in nature and has very much its ups and downs. The Life insurance business, generally speaking, is a gradual growth business. We wanted to be able to reflect a gradual increase in the dividend picture over the years commensurate with what we thought in terms of the overall organization gradual increase in income over the years, but if the Casualty company is having a bad two or three years, even though the bottom line is still going up and even though the life line is still going up, it becomes very difficult to justify an income of dividends to the Casualty shareholders, even though it's very difficult, we wanted to be in a structure where everybody would get a dividend that was properly reflective of what the organization is doing.

At least the second of those two examples does not go precisely and directly to the full-line insurance concept but I think it is part of the picture of what changes we thought would be more available to us after '64 than before and the first example about the premium surplus ratio was of concern to us and over the past ten years we have, in fact, shifted assets around in the context of a 100 percent owned unit to arrive at a more healthly surplus ratio in the Casualty company and presumably the reverse could be done.

Q I call your attention again to the second paragraph of

page 4 and specifically the phrase, "because of the view of the management of Aetna Life that state laws will permit greater flexibility in the future with respect to permitting certain types of insurance to be written by either life or casualty insurance companies,.."

A. Yes.

Q. Okay. Can you recall specifically what some of those potential changes in the law were o that you were contemplating at that time.

A. We're talking there about what is known as an all-lines charter. I think I mentioned earlier that many states have always prohibited and still prohibits one company from writing all lines of insurance. The traditional distinction has been between life insurance on the one hand and casualty and property insurance on the other. Obviously, if you really believe in the concept of full-line selling and you want to get maximum flexibility from it, you are best off by writing all of your coverages in one company.

In the past several years, we and a number of other insurance companies have tried to prompt a change in these licensin laws and chartering laws that would permit a single company to write all lines.

There are now 21 states that do permit this. Fortunatel

found we could not achieve marketing of all Aetna Casualty products in Canada through that outfit. We had to have a Canadian domiciled company.

The sixth company is Aetna Casualty & Surety Company of Illinois which has been found necessary for other reasons, reasons that achieve for us purposes that we could not achieve with these other five companies.

So, no, I don't think it necessarily follows that even with a more progressive kind of regulation we could readily liquidate either Aetna Casualty or Aetna Life.

Q Now, the last sentence of that second paragraph states, "Creation of such identity of ownership would permit the management of both companies to make discretionary business decisions without concern for conflicting stockholder interests."

That essentially has been the summation of what your testimony has been to this point.

A Yes.

Q Would you say that that sentence right there is really, in essence, the purpose for the reorganization notwithstanding the trend towards full-lines insurance?

A Well, I think -- I don't think you can read them separately. I think, yes, we are interested in the full-line

insurance trend and we are interested in having maximum flexibility in getting there. We did not have maximum flexibility as long as we had a minority shareholder group outstanding. Once we were able to get an identity of shareholder interest that problem went away.

Let me go back to the group insurance company I just mentioned, Aetna Casualty & Surety Company of Connecticut. We think it's going to be a profitable company. We think the wave of the future is to sell automobile insurance in the same way that group life insurance is now sold. One policy gets issued to the employer. The employees all contribute to it. There are no elaborate underwriting standards. Everybody pays X dollars and Y cents per month to get the same kind of coverage that you and I now have to go out and negotiate separately with our brokers. We think that's the best way of showing that we can write a reasonably-priced automobile insurance product so the Government doesn't have to step in and offer it for us.

Let's assume we're right. It is a profit-making company. Go back to pre-'64. Off which company do you hang? Aetna Life was fully permitted to own this kind of company but so is Aetna Casualty. Now, you can argue it's a casualty kind of coverage, it sort of belongs with Aetna Casualty. Maybe it is, but it's going to be marketed by people who have been marketing group life

insurance. So, we have had terrible problems trying to decide which company should have it. If we hung it off Aetna Life, the Casualty minority would have complained that we had deprived the Casualty company of a clear opportunity that belonged to it. We hang it off Aetna Casualty and we've given up 38 percent of the profit. That concern is eliminated.

I'm trying to suggest that this sentence is entirely consistent and goes hand in hand with the other statements that have been made about meeting the needs for offering full-line insurance coverage.

Q You could have done all of the things you did do after 1964 notwithstanding the reorganization, I mean, assuming that the laws were passed.

A The surplus and dividend flexibility I don't think really would have been possible without the reorganization.

Q But as far as going into this full line of insurance business, you could have gotten greater identity by increased advertising associating the two companies, is that correct?

A Yes.

Q So when you really get down to the bottom line, the reason you went through the reorganization is the fact that you could have done these things but you were worried about what the

conflicting shareholder interest would say about doing various things.

A. Yes. I think the best way to characterize it, if you're looking for the statement of the objective, is the way we did it later on when we went for some other tax rulings, when we were recounting what we did in '64 and why we did it. The principal purpose of reorganization was to create a complete identity of ownership of Aetna Life & Aetna Casualty,too, to permit the management of both companies to make discretionary business decisions without concern for conflicting shareholder interests. I think that states it as well as I can state it.

MR. DeLANA: Where were you reading from?

THE WITNESS: I'm reading from a letter dated April 4, 1967 to the Honorable Shelson S. Cohen, Commissioner of Internal Revenue, Internal Revenue Service, from a law firm by the name of Paul, Weiss, Rifkind, Wharton & Garrison.

Q. Isn't that statement essentially the same statement that's in Government Deposition Exhibit #1, that last sentence?

A. It was intended to be a fair paraphrase because it was preceded by the words, "As we advised you in our application for the 1964 ruling," which is what you and I are reading from now.

aware of any specific shareholder complaint means only that I wasn't aware of it.

Q My next question is, in the course of your dealings in planning this reorganization, had anyone ever cited to you specific instances where the conflicting shareholder interest was a problem at any time in the past?

A Well, they certainly cited instances where it was perceived to be a potential problem. If you mean did anyone cite to me a specific example of a shareholder coming in and saying we're going to sue if you continue, or go to this business practice, no, there was no -- I don't recall anybody reciting a case reaching that level.

Q All right. I call your attention to the top of page 4 and the sentence, "The primary advantage of offering full-line insurance lies in the ability to attract insurance agents who are influential in the placement with a single affiliated group of all the life, fire, casualty, bonding and other insurance needs of their clients."

Now, does this sentence relate back to the testimony you gave concerning the captive agents with the independent agents, does that come into play here?

A I think I was only telling you something about how the

organization worked in distinguishing those people who worked exclusively for the one company from those people who worked for both. I think this comes closer to the testimony I was giving about helping out the life insurance producer when he offered his casualty lines, helping out the casualty producer when he offered life insurance lines.

We made considerable efforts since '64 to try and take advantage of our independent casualty producers as people who can also bring to us life insurance coverage and that has produced some rather significant growth in the life insurance business, particularly over the last two or three years, and we've finally been able to find ways of getting our casualty producers to bring us life business. These independent agents are also involved in life insurance. They are not exclusively by any manner or means casualty or property insurance brokers.

Q Okay. Then can you have an agency, and this is prior to the reorganization now, can you have an agency that sells insurance for the Aetna Life Company and also has a contract to sell insurance for the Aetna Casualty Company?

A Yes, I think that's possible in most states, if not all, yes. It was usually the other way around. The independent agent that we placed a good deal of volume with in the casualty business

would also be involved in life insurance and we would try to get him to give us his life insurance business using our casualty relationship to do it.

Q Do you know how prevalent that dual relationship was; was it a common thing for an agent to deal that way?

A I don't know. I really can't give you any good testimony on that.

Q Now, would the relationship change at all after the reorganization when the Aetna Life obtained one hundred percent control?

A It worked, accommodation business becoming something we could more comfortably give than before the reorganization.

Q He would still be writing that insurance either for the Life company or for the Casualty company, depending on who was authorized to write either aspect.

A I don't think I fully understand the question.

Q Well, all right. Now, after the reoganization, the Aetna Life owned one hundred percent of the Casualty but still, for practical or premium writing purposes and writing insurance, you still had two separate corporations.

A Right.

Q Right?

A Right.

Q So he would still be dealing with the Life company for his life business and the Casualty company for his casualty business.

A Yes. You'd still have to have separate relationships with the two companies.

Q You have separate agency contracts?

A Yes.

Q So, then essentially nothing changed in the relationship between agents.

A That doesn't follow. Certainly the legal relationship had to stay the same but, for example, you could feel a good deal more comfortable about providing some expense reimbursement to a live producer for his casualty business, for example, out of the Life company. The Life company traditionally paid for the expenses of our life producers and in any number of ways, subject to legal limitations, we would pay up to a certain amount of entertainment expenses, up to a certain amount of overhead, up to a certain amount of selling expenses. The amounts depended on how much business the life producer has given us.

After the reorganization, it becomes possible to take into consideration the other ways in which he was helping us. If

he also had a casualty line and was giving us good and valuable casualty coverages, he could increase those expense ratios. We could help him out more than we had been by taking into account more fully the casualty production for Aetna Casualty.

Q Does the company any place in either its shareholder reports or discussions with shareholders at shareholders' meetings, do they set out this accommodation business, accommodation business per se?

A No.

Q So, would the average shareholder really be aware of that one? You're really taking business that you normally wouldn't take by trying to encourage another line of your business.

A No. Would the average shareholder be aware of it? I think if I were to go back to some of the more recent annual reports, I could show you paragraphs where we are pointing to the greater affiliation, to the use of casualty brokerage personnel to produce life business for us, yes.

Would it be as specific as my testimony? No. I have some of these annual reports here. While taking the time, I might be able to identify some of this language. I'm not sure. I think we have made mention of this in some of our shareholders' meetings.

Q Well, if we could take a few minutes here and if you

would take a look at one or two of them.

(R E C E S S)

MR. GRECO: Let's identify this for the record. This will be Government Deposition Exhibit #2 for identification.

(Annual Report, 1973, was marked Government Deposition Exhibit 2 for identification.)

Q I'll give this back to you now. I'll give it back to you and you can refer to the page and if you would, would you read that into the record.

A The kind of thing that I was talking about appears in our 1973 annual report to shareholders.

On page 15 of that report, for example, we talk about ways that we are expanding our share of the individual life market and I'll read what I think is the relevant portion of that section of the report.

We say, "While strengtheing production from its career life agents, Aetna has moved to substantially increase life insurance sales from agents whose principal business is casualty-property insurance. To develop sales from this potent marketing arm, Aetna created a new class of general agents several years

ago. Sales from this source have increased steadily and now account for 60 percent of the total volume of new individual life, health and pension business. To further develop this source of business, Aetna plans to open new life and variable annuity sales departments in more than 100 selected property-casualty agencies this year."

And it refers to property-casualty agents, to the independent agencies I was referring to earlier and then I think this is also relevant, on page 16 of the annual report when we're talking about new insurance market programs designed to serve more people and we make the following statement:

"Aetna also continues to offer individuals similar benefits through its expanding EPIC (Employee Personal Insurance Counseling) program. EPIC permits group members to purchase auto, homeowners, recreational vehicle and -- as of last year -- life insurance coverage through one convenient source and pay the premiums through payroll deductions. Premium income from EPIC sales during 1973 amounted to $15 million."

In that connection, I would point that we're talking about the coverages that are offered by two or three companies in the Aetna family, Aetna Life, Aetna Casualty and I think some of these coverages for regulartory reasons are being offered by the

automobile insurance company.

My guess, and I don't want to testify that this is hard fact, but my guess is it's much more difficult to have the three companies, if there are three, writing this coverage to go through one computer system, if you will, when you have to worry about minority interest because you get back into the kind of cost allocation, how do you divide up the profits kind of questions that were bothering us back in '64.

It may well be that some of this coverage, particularly the automobile, may not be very profitable in its own right but when used as a device for getting the life insurance, the bottom line total organization profit becomes very real.

Q Now, the passages that you've read just now, is there any way that those passages state that in effect the Aetna Life & Casualty Company are writing poorer business than maybe they should but for the fact that it's going to increase their business, they are writing this business.

Now, let me repeat it.

A I think I understand it. Let me try to answer it this way. These things are all relative. Our motivation to write marginal business in a single company is increased if we can see a bottom-line good planning figure for the consolidated organizatio

It is decreased if we can't. We still have needs to meet to the public which are going to require that we write certain marginal lines anyway, but we still have discretion as to what we can reject and accept and within the bounds of meeting corporate responsibility requirements. However ill-defined they may be, we still have an area of discretion and we tend to exercise that discretion in terms of what is good for the entire organization, what is ultimately profitable or helpful for the entire organization If that means that some companies do marginal business, then they will do it. Your question do we explain all of that in the annual report, no, we did not.

Q So, is there any way, other way through discussions that these shareholders would become aware or are actually capable, are they sophisticated enough to really understand that?

A. Our shareholders run the gamut.

Q I'm talking about an average shareholder. I'm sure you may have some insurance people.

A. Not even insurance people. A great percentage of our stock is held in nominee names and in some cases we can trace those nominees to large institutional holdings. Those large institutional shareholders will send portfolio managers, research types to us and we have a person who does nothing else than to talk

to these kinds of people and to the security analysts and in those discussions, this kind of more detailed, sophisticated analysis of why we're writing one business will surely come out.

You made this statement that you go into the casualty markets more, you know. We understand this line may not be very profitable. Why do we do it? Answer. Because overall it's profitable, even though that line may not be profitable. Those discussions do get held with the large institutional shareholders. If you're talking about a one hundred shareholder in Omaha, Nebraska, then, yes. I think the full details of the story that I'm telling you are probably not known to that shareholder but if they asked, we would tell them. We would have been much more reluctant to tell them if we were doing this in '63.

Q Now, the annual report that you read from was a shareholder report for 1973.

Now, to the best of your recollection, were any similar statements with regard to trying to increase various business through these same methods that you've described in your '73 report, were any of these statements made in any of your reports around the time of the reorganization, '62, '63, '64?

My guess would be, no, because we weren't doing much of this kind of business because of the reasons I've mentioned.

I had no responsibility with our annual reports until the last five or six years, so I can't testify from personal knowledge. We do have those reports.

Q That won't be necessary.

A These reports are tended to be a great deal more informative and extensive also over the years than they used to be.

Q Mr. Middlebrook, are you familiar with the passage of Section 815F of the Internal Revenue Code just prior to the undertaking of this reorganization?

A Yes.

Q Can you explain how you first became aware of this?

A Well, my legal responsibilities did not go directly to the tax aspects, although it was impossible to go into the reorganization extensively without being aware of the tax aspects.

In the various meetings that I've referred to, the ad hoc committee and officers' meetings, there were, of course, discussions of the tax problems that the Life company had by holding this large block of Aetna Casualty and I think I've already characterized what that problem was and I would imagine that in the course of those conversations, I must have become quite early aware that the only solution to the tax problem was to secure a

piece of legislation which would allow us to pass the Aetna Casualty stock out of the Aetna Life portfolio in a way that would not create a very severe so-called phase III liability to us. We were aware of similar legislation that Connecticut General had already obtained which was so tailored that it was uniquely available to Connecticut General. We saw equitable arguments that would allow us and other similarly situated companies that legislation in effect expanded so it would cover our quite similar situation and I would suppose that at a very early stage I must have become familiar with the Connecticut General experience, the reasons why the Connecticut ~~legislature,~~ Connecticut General ~~legislature~~ didn't quite fit our situation and what the corrective language changes that were needed to put us in the same situation as Connecticut General.

We did retain outside counsel to do most of the work involved in securing that amendment, so I don't have too much firsthand knowledge of the step-by-step process whereby it was secured, but I knew what its purpose was and it was -- I was generally following its progess through '64.

Q Do you recall the name of the outside firm?

A Yes, it's the firm I referred to earlier, Paul, Weiss, Rifkind, Wharton & Garrison.

Q Did they in effect then lobby to have this amendment to Section 815 passed?

A They must have done what is always done when you're trying to secure a change in the tax law. Who they approached, contacted, I don't know. I really don't know the precise steps that were taken to get this legislation passed.

Q Was Aetna Life the motivating factor, the catalyst for getting this provision passed; was the provision more or less geared to Aetna?

A Travelers was in a similar situation and I don't know whether other life insurance companies were also. Travelers, being a neighbor of ours, was the most familiar example to us and they were also, through their law firm, trying to secure this legislative relief.

Q Do you know who their law firm was?

A It was a Washington law firm, not the same one we were using. I think I can --

Q That's all right. It's really not extremely important.

A It was a Washington law firm.

Q Do you know if anyone from the Aetna ever testified before a House or Senate Committee regarding the passage of this section?

have been done and I'm not aware of such set of figures.

Q Okay. Now, looking at the line of figures which represent the elimination of estimated Federal income tax resulting from the transaction, how would you characterize those amounts of income tax in regard to the magnitude, its affect on the corporation, on the shareholders, were they minor?

A They were significant.

Q I see. Let me go through my notes for a second.

Do you recall what affect or what considerations or what discussions were had concerning the tax implications of the reorganization as far as what taxes you were going to save?

A I recall that there was certainly considerable discussion as to what those savings would be at the various meetings I referred to and I would assume various tables, charts were produced to show and try and calculate what those savings, tax savings would be.

Q Well, how important did the group, as a whole, consider the tax savings aspect of the reorganization?

A That's a difficult question to answer as to how important did they consider the business advantages we've mentioned and the benefit? elimination arising out of the elimination of the minority. It's almost impossible to answer that in terms of a

group basis. Certainly some individuals may well have looked at the tax savings as significant if their inclination was towards figures. Other individuals whose inclination was to the future of the business would have looked to the business advantages. I, a lawyer, think and certainly a corporate oriented lawyer would look to the obvious relief from minority shareholder problems as being significant. I think I've already quoted from the tax ruling request letter of 1967 which referred to the business purpose as the principal objective.

Did everyone in the group feel that way? I really don't know. Both were very important objectives, both for business purpose objectives arising out of the minority element and the tax objective, they were both considerable.

Q Would the Aetna Life and Aetna Casualty have undertaken the reorganization if there would have been no tax savings and no tax increase?

A. In my judgment it would have eventually made -- it would have eventually gone through a reorganization that would have allowed us to achieve the objective of a single shareholder. I said that because ever since that reorganization, in moving forward to other diversification projects which I've been involved in repeatedly, my standard instructions are to do it in such a

way that either immediately or at a guaranteed point along the line you can get rid of the minority shareholder interest and with respect to the Excelsior acquisition which I mentioned earlier which came back with the '64 reorganization, we had on numerous occasions made numerous attempts to reduce and further reduce that minority interest until today it is down to the 2 or 3 percent average point level, whereas at one point it was at least, as I think I remember, in the 20's. If it is useful, I can give you, I think, a number of examples of how we have structured deals since '64 to get rid of minority problems because of that philosophy and mentality, the fear of what a minority shareholder can do to you, the growing trend of stockholders suits from minorities. I am convinced that we have taken some steps at some point, whether or not in '64, to eliminate that minority interest, even if there had not been a specific tax savings involved.

Q Can you pinpoint specifically several examples where this fear of this conflicting shareholder interest was so dominant in the period 1963 to 1964 and why it didn't arise as a consideration, say, in 1957?

A I don't think my testimony -- I hope it hasn't indicated that all of a sudden it came upon us in '63. That's certainly not the case. I would say that we had been concerned about that

(Memorandum dated August 17, 1964 was marked Plaintiff's Deposition Exhibit 1 for identification.)

Q I don't think it is necessary for you to read the memorandum, but there are ten items, all of which are associated, as I perceive it, with the advantages resulting from the proposal that you've described.

I will give you that.

You mentioned on one or two occasions, Mr. Middlebrook, what you characterized, I assume simply for convenience of description, the so-called elimination of the minority interest. Did the plan of reorganization as perceived by the company and as a practical matter in fact eliminate the minority.

What I'm getting at is would you review the steps taken in the reoganization and tell me where the shareholders of Aetna Casualty, what interest they had in that company following the reorganization.

A I think I've also several times in the testimony referred to the need to get an identity of shareholder interest and that's really what happened. Again, the structure of the companies before the reorganization was that Aetna Life was the 62 percent owner of Aetna Casualty, 38 percent being owned by a

diverse group of shareholders. We formed a new company which I'll call New Aetna Casualty Insurance Company and merge it into that company, Aetna Casualty. We also distributed the new company in connection with that merger a certain amount of Aetna Life Insurance shares.

As a result of the merger of old Aetna into New Aetna, the old Aetna shareholders, including Aetna Life, received Aetna Life shares. We then took New Aetna, now wholly-owned by Aetna Life Insurance Company and distributed it by way of a spin-off,I believe, to a trust, which trust was formed and organized solely for the benefit of the Aetna Life shareholders so that every Aetna Life share carried with it an indivisible interest in both Aetna Life and in this trust, so that it was impossible to acquire a transfer of an Aetna Life share after the reorganization without at the same time acquiring or transferring an interest in this trust.

Therefore, since the old Aetna shareholder, the old Aetna Casualty shareholders had received Aetna Life shares and since those Aetna Life shares came to represent an interest in the trust which held all of the New Aetna stock, we didn't really eliminate the minority at all. We simply put it into the same kind of ownership position as all of the other Aetna Life shareholders.

The Aetna Life stock acquired by Aetna Life itself was simply retired. So, we merged with a single shareholding group, whereas, before we had had two separate shareholding groups. It happened that there were no dissenting shareholders at all, so the morning after the reorganization took place, all of the former shareholders of old Aetna Casualty were now shareholders of the Aetna Life with the staple interest in the Aetna and Aetna Casualty stock trust.

Q Would it be fair to characterize the reorganization from the standpoint of an Aetna Casualty shareholder as a shift of his interest?

A Yes, whereas normally he owned an interest solely in a casualty company, he now owns an indivisible combined interest in a casualty company and a life company.

Q Did the staple trust permit the shareholders of Aetna Life and therefore the shareholders of old Aetna Casualty to terminate that trust agreement so that at such time as they were to by vote determine, the trustee would have been in a position of distributing to the old Aetna Casualty's shareholders, now shareholders of Aetna Life, the stock of what was then old Aetna Casualty?

A If you mean by that could the old Aetna Casualty people

trust. Everything else is the same. The reorganization occurred.

MR. DeLANA: Let me make the observation, and Mr. Middlebrook can confirm it, the plan of reorganization is contemplated from the very beginning and had built into it the shift of ownership interest by the old Aetna Casualty shareholders: that is, the spin-off of those interests to the shareholders was a very definite and integral part of the transaction and, in fact, the spin-off occurred the day following the reorganization we're talking about here.

So, your comments are addressed to the hypothetical situation which was not the reality, that the reorganization was simply an acquisition by Aetna Life of the outstanding minority interest in the Aetna Casualty Company.

BY MR. GRECO:

Q Now, I think my last statement to you was would a shareholder who owned one hundred shares of stock in a life company come in and have the right to take that chair that you're sitting on.

A You mean if Aetna Life were to be liquidated?

IN THE UNITED STATES DISTRICT COURT FOR THE

DISTRICT OF CONNECTICUT

THE AETNA CASUALTY AND SURETY COMPANY, for itself and as successor by merger to The Aetna Casualty and Surety Company, Plaintiff v. UNITED STATES OF AMERICA, Defendant	CIVIL ACTION NO. H-131

AMENDED ANSWER

Defendant, United States of America, by its attorney, Peter C. Dorsey, United States Attorney for the District of Connecticut, answers the complaint herein as follows:

1. Admits the allegations contained in paragraph 1.
2. Admits the allegations contained in paragraph 2.
3. Admits the allegations contained in paragraph 3.
4. Admits the allegations contained in paragraph 4.
5. Denies the allegations contained in paragraph 5.
6. Denies the allegations contained in paragraph 6.
7. Admits the allegations contained in paragraph 7.
8. Admits the allegations contained in paragraph 8.
9. Admits the allegations contained in paragraph 9.
10. Admits the allegations contained in paragraph 10.
11. Admits the allegations contained in paragraph 11.
12. Denies the allegations contained in paragraph 12.
13. Admits the allegations contained in paragraph 13, except denies each and every allegation contained in Exhibit A, unless expressly admitted herein.
14. Admits the allegations contained in paragraph 14.
15. Admits the allegations contained in paragraph 15, except denies each and every allegation contained in Exhibit B, unless expressly admitted herein.
16. Admits the allegations contained in paragraph 16.

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17. Denies the allegations contained in paragraph 17.

18. Admits the allegations contained in paragraph 18, except denies amounts were unlawfully collected.

19. Admits the allegations contained in paragraph 19.

20. Admits the allegations contained in paragraph 20.

WHEREFORE, defendant denies that plaintiff is entitled to a judgment in the sum of $4,071,665.21, plus deficiency interest of $395,975.38, or any other sum whatsoever, and demands that judgment be entered in its favor dismissing the complaint with prejudice with costs to defendant as allowed by law.

United States Attorney

CERTIFICATE OF SERVICE

IT IS HEREBY CERTIFIED that copies of the foregoing Motion to File an Amended Answer and Amended Answer, has this 29th day of January, 1975, been served on counsel for the plaintiff by mail, postage prepaid, addressed to:

William Delana, Esquire
Day, Berry & Howard
One Constitution Plaza
Hartford, Connecticut 06103

Robert M. Greco

Robert M. Greco
Trial Attorney
Tax Division
Department of Justice
Washington, D. C. 20530

IN THE UNITED STATES DISTRICT COURT FOR THE

DISTRICT OF CONNECTICUT

THE AETNA CASUALTY AND SURETY COMPANY, for itself and as successor by merger to The Aetna Casualty and Surety Company,	)	
Plaintiff	)	CIVIL ACTION NO. H-131
v.	)	
UNITED STATES OF AMERICA,	)	
Defendant	)	

MOTION FOR SUMMARY JUDGMENT

The defendant, United States of America, by its attorney, Peter C. Dorsey, United States Attorney for the District of Connecticut, pursuant to Rule 56 of the Federal Rules of Civil Procedure respectfully moves that judgment be entered in its favor with such costs to defendant as are allowed by law. There is no dispute as to any material fact and the reasons in support of the defendant's motion are set forth in defendant's Brief.

UNITED STATES ATTORNEY

By: Assistant United States Attorney

COPY OF ORIGINAL
Filed 2 . 21 1975
United States District Court
District of Connecticut

IN THE UNITED STATES DISTRICT COURT FOR THE

DISTRICT OF CONNECTICUT

THE AETNA CASUALTY AND SURETY COMPANY, for itself and as successor by merger to The Aetna Casualty and Surety Company,	)	
Plaintiff,	)	
vs.	)	CIVIL ACTION NO. H-131
UNITED STATES OF AMERICA,	)	
Defendant.	)	

PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

The plaintiff, The Aetna Casualty and Surety Company, for itself and as successor by merger to The Aetna Casualty and Surety Company, by its attorney, William G. DeLana, of Day, Berry & Howard, respectfully moves, pursuant to Rule 56 of the Federal Rules of Civil Procedure, that the Court enter judgment in its favor. There is no dispute as to any material fact, and the motion is based on the pleadings and stipulation of facts on file with the Court and on the plaintiff's memorandum in support of this motion.

Dated this 21st day of February, 1975.

PLAINTIFF
The Aetna Casualty and Surety Compa[illegible]

By William G. DeLana
William G. DeLana
of Day, Berry & Howard
Its Attorneys

CERTIFICATION

A copy of the foregoing Plaintiff's Motion for Summary Judgment has been mailed this 21st day of February, 1975, postage prepaid, to counsel for the defendant, addressed as follows:

Robert M. Greco, Esquire
Tax Division
United States Department of Justice
Washington, D.C. 20530

William G. DeLana
William G. DeLana

UNITED STATES DISTRICT COURT

DISTRICT OF CONNECTICUT

THE AETNA CASUALTY AND SURETY COMPANY, for itself and as successor by merger to The Aetna Casualty and Surety Company	:	CIVIL NO. H-131
v.	:	
UNITED STATES OF AMERICA	:	

MEMORANDUM OF DECISION

This is a tax refund suit involving the complex reorganization provisions of the Internal Revenue Code. The plaintiff seeks over $4.4 million dollars, plus interest, which it claims to have overpaid in taxes. A review of the background of this case will make this claim more understandable. The parties have stipulated to most (and disagree as to none) of the material facts and have entered cross-motions for summary judgment.

I.

Aetna Life Insurance Co. (Aetna Life) is a Connecticut company that writes and sells life, accident, and health insurance throughout this country and Canada. Until December 29, 1964, the Aetna Casualty and Surety Co. (Old Aetna) was a Connecticut company that wrote and sold liability, fire, theft, property damage, and surety insurance. Aetna Life had

owned more than 50 per cent of Old Aetna's 7,000,000 shares of common voting stock continuously since 1958. By December 29, 1964, Aetna Life owned some 4,312,535 shares (61.61 per cent).

A.

The Life Insurance Company Income Tax Act of 1959, Pub. L. No. 86-69, § 2(a), 73 Stat. 112, substantially changed the manner in which life insurance companies are taxed. For present purposes it is only important to understand that one of the effects of that Act was to make Aetna Life's taxes depend in part upon its asset base: the larger its assets, the greater its taxes. See Int. Rev. Code of 1954, §§ 802(a)(1), (b), 804(a)(1), 805(a)(1), (b)(2)(B), (b)(4). Among Aetna Life's assets was its ownership of 61.61 per cent of the stock of Old Aetna.

Aetna Life understandably wished to remove this interest in Old Aetna from its asset base. The obvious way to accomplish such a purpose was to distribute the assets to its shareholders.[1/] In the context of insurance company taxation however, such a route was problematical. The Int. Rev. Code of 1954, § 802(b)(3) makes certain portions of "distributions to shareholders" taxable to the life insurance company.

1/ If a spin-off distribution is of stock of an 80 per cent "controlled" corporation, as defined in § 368(i), the receiving shareholders recognize no gain or loss from the transaction. See Int. Rev. Code of 1954, § 355(a)(1)(D)(ii).

Because a distribution of Old Aetna stock apparently would have come within § 802(b)(3), Aetna Life sought to have the law amended. In 1964 it succeeded. Act of Sept. 2, 1964, Pub. L. No. 88-571, § 4(a)(2), 78 Stat. 859, added, inter alia, the language that is now Int. Rev. Code of 1954, § 815(f)(3)(B). The language provided two avenues by which Aetna Life could distribute its Old Aetna holdings without tax consequences to itself; the routes were circuitous and narrowly defined:

> "(f) Distribution defined.--For purposes of this section, the term 'distribution' includes any distribution in redemption of stock or in partial or complete liquidation of the corporation, but does not include--
>
> . . . .
>
> (3) any distribution after December 31, 1963, of the stock of a controlled corporation to which section 355 applies, if such controlled corporation is an insurance company subject to the tax imposed by section 831 [2/] and if--
>
> . . . .
>
> (B) control has been acquired after December 31, 1957--
>
> (i) in a transaction qualifying as a reorganization under section 368(a)(1)(B), if the distributing corporation has at all times since December 31, 1957, owned stock representing not less than 50 percent of the total

2/ Int. Rev. Code of 1954, § 831 provides rules for the taxation of insurance companies other than life insurance companies. Old Aetna was apparently such a company. So was an entity described below--New Aetna.

combined voting power of all classes of stock entitled to vote, and not less than 50 percent of the value of all classes of stock, of the controlled corporation, or

(ii) solely in exchange for stock of the distributing corporation which sto[illegible] immediately exchanged by the con[illegible]d corporation in a transaction qualifying as a reorganization under section 368(a) (1) (A) or (C), if the controlled corporation has at all times since its organization been wholly owned by the distributing corporation and the distributing corporation has at all times since December 31, 1957, owned stock representing not less than 50 percent of the total combined voting power of all classes of stock entitled to vote, and not less than 50 percent of the value of all classes of stock of the corporation the assets of which have been transferred to the controlled corporation in the section 368(a) (1) (A) or (C) reorganization."

In order to fit within this language,[3/] Aetna Life proposed to organize the Farmington Valley Insurance Co. (Farmington Valley), a wholly owned shell subsidiary. Aetna Life would issue 13,300,000 shares of its voting common stock and exchange them for all 1000 shares of Farmington Valley. Then, pursuant to a reorganization plan approved in November 1964 by the shareholders of Farmington Valley and Old Aetna,[4/]

3/ The parties disagree as to which subsection fits the transaction described below in the text. *Cf.* note 17 *infra*. They agree, however, that the ultimate distribution fitted within one of these exceptions to the imposition of tax on certain distributions to shareholders.

4/ The parties also agree that the procedures followed in the approval and execution of the plan conformed to those required

Farmington Valley would exchange its sole assets--the Aetna Life stock--for the voting common stock held by the Old Aetna shareholders in the ratio of 1.9 shares of Aetna Life stock for each share of Old Aetna stock. The Aetna Life stock received by Aetna Life in return for its 61.61 per cent holding in Old Aetna would be retired. The Old Aetna stock received by Farmington Valley, the surviving company, would be cancelled. Farmington Valley would change its name to Aetna Casualty and Surety Co. (New Aetna) and, by operation of Connecticut's merger law, succeed to all of the assets and liabilities of Old Aetna. The management, business, and all of the attributes of Old Aetna would continue under the aegis of New Aetna. Aetna Life would then distribute the 1000 shares of New Aetna (formerly Farmington Valley) by putting them into a trust for the benefit of all of Aetna Life shareholders. Evidence of a proportional beneficial interest in the trust would be "stapled" to each Aetna Life share so that both the Aetna Life share and its proportionate beneficial interest in the trust of New Aetna shares would always be held by the same owner.

After having received approval from the Connecticut Insurance Commissioner and a ruling from the Internal Revenue Service (IRS) that the "acquisition by [Farmington Valley] of

4/ cont'd

by the 1964 versions of Conn. Gen. Stat. Ann. §§ 33-364 to 33-369. Thus the plan, when carried out, effected a merger under Connecticut law.

substantially all of the assets and assumption of the liabilities of [Old Aetna] in exchange solely for voting stock of Aetna Life will constitute a reorganization within the meaning of section 368(a)(1)(C) of the Code,"[5/] the three companies carried out the plan described above on December 29, 1964. As the IRS found it to fit within the new exception to § 815, the nontaxability of the transaction desired by the parties came to pass.[6/]

B.

During 1964 Old Aetna and New Aetna incurred total net operating losses of $7,292,741. Of these, $7,253,144 were attributable, on a pro rata basis,[7/] to Old Aetna; $39,597 of

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5/ Ruling Letter from J. Littleton to A. DeWind, Oct. 23, 1964 at 5 (Exh. E to Stipulation of Facts).

6/ Aetna Life used the complex procedure that it designed instead of simply making a tender offer to raise its interest i Old Aetna to 80 per cent, the "control" level. See Int. Rev. Code of 1954, § 368(c). This might have qualified as a reorganization under § 368(a)(1)(B), cf. B. Bittker & J. Eustic Federal Income Taxation of Corporations and Shareholders ¶ 14.53, at 14-117 (3d abr. ed. 1971), and might have allowed distribution of Aetna Life's interest in Old Aetna to its shareholders without tax consequences to itself. See Int. Re Code of 1954, § 815(f)(3)(B)(i); cf. note 17 infra. If this route had been chosen and had succeeded the problem being litigated here, see pp. 6-9 infra, would never have arisen.

The advantage to Aetna Life of the procedure actually used was its complete elimination of all minority interests i Old Aetna, a goal of importance to Aetna Life. Furthermore, dissenters would be able to receive only an appraised value o their stock. Conn. Gen. Stat. Ann. §§ 33-373 to 33-374 (1964

7/ That is, 364/366 of the losses were attributed to Old Aetna 2/366 of the losses were attributed to New Aetna. This is be cause the transfer took place on December 29, 1964.

the losses were attributable to New Aetna.[8/] During 1965 New Aetna incurred net operating losses of $11,594,322. Under Int. Rev. Code of 1954, § 172 operating losses of a taxpayer may be "carried back" to reduce its taxable income earned during the three preceding years.[9/] The IRS allowed Old Aetna, apparently in its final return, to carry back its $7,253,144 share of 1964 losses to offset its 1961-62 and pa[rt] of its 1963 taxable income. But it disallowed any carryback of New Aetna's 1964 and 1965 losses to offset the remainder of Old Aetna's 1963 income. The parties agree that if the carryback were allowed, New Aetna would be entitled to a refund of $4,071,655.21, plus the $395,975.38 of deficiency interest paid with respect thereto, plus legal interest on both such amounts.

The grounds of the IRS disallowance of the carryback are set forth in its technical advice memorandum of August 2[illegible] 1968 (Exh. J to Stipulation of Facts). The IRS relied on In[t.]

8/ Int. Rev. Code of 1954, § 381(b)(1) provides that for certain corporate reorganizations in which what is acquired consists of _assets_ the taxable year of the acquired corporation shall end on the date of the acquisition. The IRS contends that the acquisition herein described is governed by this ru[le]. Although the plaintiff acted as if this rule applied in 1964 it now contends that § 381(b)(1) is irrelevant to the transaction undertaken because no reorganization occurred, or the re[-]organization that took place is explicitly excepted from § 381(b)(1), or the reorganization did not involve an acquisition of assets.

9/ Int. Rev. Code of 1954, § 832(c)(10) makes the deduction rules for "normal" taxpayers applicable to insurance compani[es] other than life insurance companies, _i.e._, Old and New Aetna For convenience I refer simply to § 172, although more preci[sely] the authority for a loss carryback is § 832(c)(10) as it incorporates § 172.

Rev. Code of 1954, § 381, which is first concerned with "carryovers" in certain corporate acquisitions:

> "(a) General rule.--In the case of the acquisition of assets of a corporation by another corporation--
>
> (1) [This deals with the basis of assets distributed.]
>
> (2) in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D) . . . or (F) of section 368(a) (1),
>
> the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in subsection (c) of the distributor or transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c)."

Section 381 also deals specifically with "carrybacks" as follows:

> "(b) Operating rules.--Except in the case of an acquisition in connection with a reorganization described in subparagraph (F) of section 368(a) (1)--
>
> . . .
>
> (3) The corporation acquiring property in a distribution or transfer described in subsection (a) shall not be entitled to carry back a net operating loss for a taxable year ending after the date of distribution or transfer to a taxable year of the distributor or transferor corporation."

As it stated in its earlier ruling letter, the IRS contends that the transaction described above was a C reorganization,[10]

10/ Tax lawyer jargon refers to reorganizations by letter; the letter corresponds to the subsection of Int. Rev. Code of

and that therefore § 381(b)(3) excludes New Aetna, the "corporation acquiring property in a . . . [C reorganization, as] described in subsection (a)," from carrying back "a net operating loss for a taxable year ending after the date of . . . [the reorganization] to a taxable year of" Old Aetna the transferor.

New Aetna, the plaintiff, makes several distinct arguments to support its position that the IRS is wrong and that it is indeed entitled to the carryback it seeks. These are described in the sections below.

To determine whether losses sustained by New Aetna after the merger may be carried back and offset against income earned by Old Aetna before the reorganization requires consideration of the special limitations of § 381, relating to "loss carrybacks," for, unlike the loss carryforwards permitted following all acquisition reorganizations, carrybacks of post-reorganization losses are permitted only in F reorganizations.

10/ cont'd

1954, § 368(a)(1) which applies to the particular reorganization. For convenience and brevity I will adopt this shorthand method of notation herein.

Section 368 only defines transactions which are reorganizations. The tax consequences of reorganization exchanges and distributions is determined by separate provisions.

A C reorganization is "the acquisition by one corporation in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation . . . ." Int. Rev. Code of 1954 § 368(a)(1)(C).

II.

The plaintiff's broadest argument is that the transaction described above did not consist of a "reorganization" at all, but was nothing more than a "redemption" of the minority shareholders' interest in Old Aetna. If this be true, § 381's exclusion of a loss carryback does not apply to the plaintiff,[11/] and the general loss carryback rule of § 172 cf. p. 7 supra, would entitle the plaintiff to its refund.

The plaintiff's argument is based on the decision by the Tax Court in Casco Prods. Corp., 49 T.C. 32 (1967). Casco Prods. involved a very similar set of circumstances, varying materially from this case only in that (1) the companies involved were not in the insurance business and (2) the IRS had never been asked to rule that a reorganization had occurred. Casco, the surviving company in the merger there, sought to use the § 172 loss carryback rules, arguing that what had occurred was an F reorganization,[12/] and was thus excepted from the § 381(b) exclusion from the benefits of § 172. See Int. Rev. Code of 1954, § 381(b), quoted at p. 8 supra. The IRS denied that an F reorganization had occurred.

11/
The exclusion of § 381(b)(3) applies only to a "corporation acquiring property in a distribution or transfer described in subsection(a)." Section 381(a) describes, in relevant part, only transfers "in connection with a reorganization" (emphasis added).

12/
"[A] mere change in identity, form, or place of organization, however effected." Int. Rev. Code of 1954, § 368(a)(1)(F).

The Tax Court "declin[ed] the invitation to attempt to navigate [the] treacherous shoals" of defining the reach of § 368(a)(1)(F), 49 T.C. at 36, and instead took a different tack, deciding that the transaction was actually only a redemption of 9 per cent of the shares of Old Casco (the company comparable to Old Aetna here). Thus "the merger was a reorganization in form only and should consequently be ignored as such." Id., at 37.[13/]

Although the Casco Prods. analysis is intriguing, its reasoning is not persuasive. Here the transaction was more than a merely "formal" reorganization. One of Aetna Life's fundamental objectives was to remove the Old Aetna stock from its asset base in a tax-free transaction. In order to achieve this objective the transaction was specifically required to be a "reorganization" within the meaning of § 368(a)(1). See Int. Rev. Code of 1954, § 815(f)(e)(B), quoted at pp. 3-4 supra. Thus, the fact that this case involves the special problems of insurance company taxation materially distinguishes it from Casco Prods.

Casco Prods. is the only case found by the parties or the court which has ignored in circumstances such as this what

13/ The Tax Court considered possibly significant the fact that Standard Kollsman had actually attempted to acquire all of Old Casco's stock. But cf. South Bay Corp. v. Commissioner, 345 F.2d 698, 701-705 (2d Cir. 1965). Here Aetna Life did not first attempt to acquire all of Old Aetna's stock by tender offer or by having Old Aetna attempt to redeem the minority shareholders' interests. In view of my rejection of the Casco Prods. analogy, explained below in the text, I do not decide whether this distinction would be material.

on its face is a reorganization. A distinction between it and the present case has already been noted. But, more fundamentally, I do not agree with the Tax Court's approach. Courts should look through form to substance when deference to the form of the transaction will defeat the purposes of the tax laws. It is not a policy that courts can use simply to duck hard cases. _See_, _e.g._, _United States v. General Geophysical Co._, 296 F.2d 86, 87 (5th Cir. 1961), _cert. denied_, 369 U.S. 849 (1962):

> "The solution of hard tax cases requires something more than the easy generalization that the substance rather than the form of a transaction is determinative of its tax effect, since in numerous situations the form by which a transaction is effected does influence or control its tax consequences. . . ."

Giving effect to the form of the transaction here would not at all subvert the tax laws. Rather, not giving effect to the form would risk improper tax treatment in this case. The Aetnas sought and received an IRS ruling that their plan constituted a C reorganization.14/ As a result Aetna Life

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14/ Indeed, plaintiff's counsel had specifically requested a ruling from the Treasury Department that "4. The merger of Aetna Casualty into New Corporation and the transfer of the Aetna Life stock held by New Corporation to the shareholders of Aetna Casualty on such merger _will constitute a reorganization within the meaning of section 368(a)(1)(C)._" _See_ Ruling Request Letter from A. DeWind to E. Harding, Sept. 9, 1964, at 8 (Exh. C to Stipulation of Facts).

The response from the Treasury Department stated: "(4) The acquisition by New of substantially all of the assets and the assumption of liabilities of Aetna Casualty in exchange solely for voting stock of Aetna Life will _constitute a reorganization within the meaning of section 368(a)(1)(C) of the Code_.

received a substantial, annually-recurring tax benefit.[15/] Now (after the statute of limitations has long since run for the IRS to challenge the tax treatment accorded Aetna Life) New Aetna seeks to receive additional benefits on an inconsistent theory. In this circuit, such conduct does not by itself allow an estoppel to be worked against the taxpayer. See Stair v. United States, 516 F.2d 560 (2d Cir. 1975). But cf. 10 J. Mertens, The Law of Federal Income Taxation § 60.04 (rev. ed. 1970), and cases cited therein. But the possibility of such inconsistent positions points up the dangers of indiscriminately ignoring formalities in order to look "through" form to substance. I do not feel free to do that. In view of all these considerations, I decline to follow the Tax Court decision in Casco Prods. Since they do not deny that the Aetnas' plan is described by a subsection of § 368(a)(1), there can be no doubt that a reorganization occurred. However, the type of reorganization it was is also significant.

III.

New Aetna's next argument is that the transaction undertaken constituted a B reorganization. Int. Rev. Code of 1954, § 368(a)(1)(B) provides that one form of reorganization is

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15/ The Plan of Reorganization sent to shareholders pointed out that Aetna Life's tax for the year 1963 would have been $2,700,000 less without the ownership of the Aetna Casualty shares and estimated the annual tax saving at $1,980,000. (Exh. H to Stipulation of Facts, at 7).

> "the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition) . . . ."

In this case the acquiring corporation would be Farmington Valley (New Aetna); Aetna Life would be the corporation controlling the acquiring corporation; and Old Aetna would be the company acquired.[16/]

According to New Aetna, a B reorganization escapes the loss carryback exclusion of § 381(b)(3), thereby making the

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16/ The plaintiff claims that there is no inconsistency between this argument and the earlier IRS ruling that a C reorganization occurred. (New Aetna does not challenge the correctness of that ruling.) New Aetna's point is that a transaction may be described by two (or more) overlapping subsections of § 368(a)(1). In some contexts this point is unarguable. The authority cited by the plaintiff supports its position that a reorganization may qualify under subsection (F) of § 368(a)(1) and under some other subsection as well. See, e.g., Rev. Rul. 57-276, 1957-1 Cum. Bull. 126; Estate of Stauffer v. Commissioner, 403 F.2d 611, 617 (9th Cir. 1968). And the statute itself recognizes that there may be overlaps between C and D reorganizations. See Int. Rev. Code of 1954, § 368(a)(2)(A). But there is no authority for making the proposition a universally applicable one, as the plaintiff would do. The descriptions of the transactions covered by subsections (B) and (C) might well be mutually exclusive.

Whether subsections (B) and (C) are necessarily inconsistent makes a difference in this case. As explained immediately below in the text, it is New Aetna's position that B reorganizations are exempt from the loss carryback exclusion of § 381(b)(3); C reorganizations are clearly covered by the exclusion. If the two types of reorganizations are inconsistent, then determining which type is involved in the transaction in question disposes of the loss carryback issue.

loss carryback allowance of § 172 applicable. The argument, which in general seems correct, is that the exclusionary language in § 381(b)(3) applies only to a "distribution or transfer described in subsection (a)." Subsection (a) of § 381 applies only to "the acquisition of the assets of a corporation by another corporation . . . in a transfer . . . in connection with a reorganization described in subparagraph (A), (C), (D), . . . or (F) of section 368(a)(1)." A B reorganization is not mentioned, and, as the plaintiff points out, Treas. Reg. § 1.381(a)-1 (b)(3)(i) (1960) says that § 381 does not apply to transactions mentioned therein. Thus, if the transaction in this case was a B reorganization, the § 381(b)(3) exclusion would not bar the loss carryback sought by New Aetna.[17/]

If Farmington Valley had simply acquired all of the stock of Old Aetna, there would be no question but that a B reorganization had occurred. In these circumstances Farmington Valley would continue to exist only as a holding company for Old Aetna, which would continue to be the operating entity. (And Old Aetna could carry back its 1965 losses to

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17/ *Cf.* note 16 *supra*.

Perhaps Aetna Life could have achieved the first step of its tax goal (removing its interest in Old Aetna from its asset base in a tax-free transaction) by use of a B reorganization to acquire all of Old Aetna shares and then distribute them to a trust. However, by adopting the merger route Aetna Life was able to freeze out the outside shareholders of Old Aetna in a manner that it could not have done in a B acquisition. But obtaining that advantage carried certain limitations with it, as will be seen later.

offset its 1963 taxable income.) The complicating factor in this case is the statutory merger of the two companies in which Old Aetna disappeared and Farmington Valley survived (as New Aetna).18/ The question, then, is whether a stock-for-stock triangular reorganization (where the acquiring company, a shell subsidiary created specially for purposes of the transaction, exchanges its parent's stock for stock of the acquired company § 368(a)(2)(D)) in which the acquired company is merged into the acquiring company (subsidiary merger) qualifies as a B reorganization.19/

The plaintiff's argument is based entirely on an analogy which it urges me to adopt. In several revenue rulings the problem has been posed whether a stock-for-stock triangular reorganization qualifies as a B reorganization. The IRS has held that such transactions may constitute B reorganizations. See Rev. Rul. 74-565, 1974 Int. Rev. Bull. No. 47,

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18/ One form of reorganization, an A reorganization, is defined as "a statutory merger or consolidation." Int. Rev. Code of 1954, § 368(a)(1)(A). For purposes of the loss carryback rules, such reorganizations are treated the same as C reorganizations, i.e., no loss carryback is permitted. See Int. Rev. Code of 1954, § 381(a)(2), (b)(3). The transaction here in issue, although involving a statutory merger, apparently did not qualify as an A reorganization because the stock exchanged for Old Aetna stock was not Farmington Valley stock but Aetna Life stock. See S. Rep. No. 1653, 90th Cong., 2d Sess. (1968), 1968-3 U.S. Code, Cong. & Admin. News 4440, 4441. It was not until 1968 that such a transaction would have qualified as an A reorganization. Act of Oct. 22, 1968, Pub. L. No. 90-621, § 1(a), 82 Stat. 1310 (codified at Int. Rev. Code of 1954, § 368(a)(2)(D)). Cf. note 20 infra.

19/ A C reorganization, as found to exist here, is a transaction involving two corporations dealing directly with each other at the corporate level; on the other hand, a B reorganization involves a transaction between an acquiring corporation and the individual shareholders of the target corporation.

at 8; Rev. Rul. 74-564, 1974 Int. Rev. Bull. No. 47, at 7; Rev. Rul. 67-448, 1967-2 Cum. Bull. 144. The sole distinction between the cases there ruled upon and the problem presented here is that in those cases the acquired company survived the acquisition process; here Old Aetna did not. Under Connecticut law all assets of the merged corporation (Old Aetna) became assets of the surviving corporation (New Aetna) without any further act or deed. Conn. Gen. Stat. Ann. § 33-369(e).

It is often difficult to construe tax statutes in a coherent and rational way. But it was not incongruent for the draftsmen to omit B reorganizations from § 381. A reasonably consistent underlying theory is discernible. The common element among the transactions covered by the § 381(b)(3) loss carryback exclusion is that the company incurring the losses is a different entity from the company to which the losses would be carried back. This is a basic distinction and not surprising, for the § 172 carryback provision assumes only a single taxpayer. A taxpayer corporation cannot normally "assign" its loss carryback to some other company. See New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440-442 (1934). The significance of this is bolstered by the fact that the common element among those reorganizing transactions not falling within the loss carryback exclusion is that the same entity that incurs the losses earned the income against which they will be offset. Cf. Estate of Stauffer v. Commissioner, 403 F.2d 611, 622 (9th Cir. 1968). Where there has simply been a "recapitalization," see Int. Rev. Code of 1954,

§ 368(a)(1)(E), the same corporate entity remains. See B. Bittker & J. Eustice, supra note 6, § 14.17, at 14-59. Where there has been a B reorganization not involving a merger two corporations remain, and each may carry back its losses to offset its own earlier income. Where there has been a B reorganization and a merger in which the acquiring company (a shell) is merged into the acquired company, the operating company survives and can carry its later losses back to offset its own earlier income. Cf. Rev. Rul. 67-448, 1967-2 Cum. Bull. 144.

The plaintiff argues that this is a distinction without a difference; the direction of the merger should not matter.[20/] I cannot agree. Had the merger been in reverse,

20/ The plaintiff relies upon a statement in S. Rep. No. 91-1533, 91st Cong., 2d Sess. (1970), 1970-3 U.S. Code, Cong. & Admin. News 6123, 6124, that "there is no reason why a merger in one direction . . . should be taxable, when the merger in the other direction . . . , under identical circumstances, is tax-free." In context, however, this statement is seen to be inapposite. As discussed in note 18 supra, in 1968 Congress amended the tax laws to allow transactions to be treated as A reorganizations where the acquiring company exchanged its parent's stock instead of its own for properties of the acquired company (which disappeared in the merger). But where there was a reverse merger--the acquiring company being merged into the acquired--and the acquiring company used its parent's stock, treatment as an A reorganization remained barred. In 1971 Congress accorded such reverse mergers the same treatment as it accorded mergers in the other direction in 1968. Act of Jan. 12, 1971, Pub. L. No. 91-693, § 1(a), 84 Stat. 2077 (codified at Int. Rev. Code of 1954, § 368(a)(2)(E)). It was in the course of the Senate report on this Act that the statement quoted by the plaintiff appears.

The question considered by the Senate report, then, was whether the use of a parent's stock should make a transaction taxable or not depending upon the direction of the merger. (It is clear that where a parent's stock is not involved, a

Old Aetna would have acquired either all of the assets of New Aetna (an asset sale) or all of the stock of New Aetna (a stock sale) and Aetna Life (or New Aetna) would have received an additional 61 per cent of newly issued voting stock of Old Aetna in the exchange. Aetna Life's ability to meet the requirements of § 815(f)(3)(B) would not have been improved at all.

Viewed against this background it is clear that the direction of the merger in this case did make a difference. Since it was the operating company, Old Aetna, that disappeared in the merger, the losses sought to be carried back to offset Old Aetna's income are those incurred by a different company.

20/ cont'd

merger in either direction can qualify as an A reorganization. In the present case, however, the taxability of the transaction is not at issue. If the merger in a case like the present one is such that the acquiring company disappears, the transaction is now nontaxable either as an A reorganization, see Int. Rev. Code of 1954, § 368(a)(2)(E), or, if it does not qualify thereunder, as a B reorganization, see, e.g., Rev. Rul. 74-565, 1974 Int. Rev. Bull. No. 47, at 8. If the merger, as here, is such that the target company disappears, the transaction is now nontaxable as an A reorganization, see Int. Rev. Code of 1954, § 368(a)(2)(D), or, if it does not qualify thereunder and if the IRS continues to rule as it did in the case of the Aetnas, it is nontaxable as a C reorganization. Cf. Rev. Rul. 67-448, 1967-2 Cum. Bull. 144, 145. The question in the present case, then, is whether such a transaction should be not only nontaxable but also exempt from the loss carryback exclusion of § 381(b)(3) as a B reorganization. The issue of exemption from the loss carryback exclusion was not involved in the problem considered by the Senate report quoted by the plaintiff, and, as seen below in the text, the direction of the merger might well be relevant to this issue although irrelevant to the issue of the taxability of the transaction. See generally, Rachofsky, The Reorganization That Fails: Tax Consequences of an Involuntarily Taxable Reorganization, N.Y.U. 32d Inst. on Fed. Tax, Pt. 1, 639, 640-663 (1974).

To allow this carryback, i.e., to call the transaction undertaken in this case a B reorganization, would subvert the clear intent of the Code to disallow loss carrybacks across corporate lines.[21/] In the absence of any compelling consideration mandating that this transaction be treated as a B reorganization, I cannot accept the plaintiff's argument and the violence that it would do to the structure and purpose of the Code.[21A/]

IV.

Another argument raised by New Aetna is that the transaction which occurred amounted to an F reorganization--"a mere change in identity, form, or place of organization, however effected." Int. Rev. Code of 1954, § 368(a)(1)(F).[22/] If this be true, the transaction is expressly excepted from the § 381 (b)(3) exclusion from the loss carryback benefits of § 172. See Int. Rev. Code of 1954, § 381(b), quoted at p. 8 supra.[23/]

21/
In both this case and the case described by Rev. Rul. 67-448, 1967-2 Cum. Bull. 144, one of the two merged companies has been a shell subsidiary created solely for purposes of the transaction. A third possible case would involve an operating subsidiary merging with an operating company. The analysis above is not intended to intimate any views as to the proper tax treatment of such a transaction.

21A/
Whether the 61.61 per cent of Old Aetna held by Aetna Life had been acquired solely in exchange for voting stock has not been established. Cf. Helvering v. Southwest Consol. Corp., 315 U.S. 194, 198 (1942). Therefore, I do not reach the question of whether the use of a shell corporation as a conduit insulates against compliance with the requirements of § 368(a)(2)(B) that 80 per cent control must be acquired solely in exchange for voting stock or in unrelated transaction

22/
The plaintiff notes that the IRS has desigated the scope of subsection (F) of § 368(a)(1) a "prime issue" for litigation and resolution. IRS Manual (MT 1277-8, Nov. 19, 1974).

23/
See note 16 supra. And Treas. Reg. § 1.381(b)-1(a)(2) (1960) provides in part:

In considering whether there was an F reorganization here it should be noted that it is not irrational for an F reorganization to also meet the requirements of (A), (C) or (D) of § 381(a)(1). The Commissioner has so ruled in Rev. Rul. 57-270, 1957 Cum. Bull. 126. See also Estate of Stauffer v. Commissioner, 402 F.2d 611, 617 n.7.

The case law has established a number of requirements for qualification as an F reorganization. The IRS raises no challenge to the Aetnas' compliance with most of them. The sole requirement that the IRS contends is unmet in the circumstances of this case is that there be no significant[24/] shift

23/ co 'd

> "In the case of a reorganization qualifying under section 368(a)(1)(F) (whether or not such reorganization also qualifies under any other provision of section 368(a)(1)), the acquiring corporation shall be treated (for purposes of section 381) just as the transferor corporation would have been treated if there had been no reorganization. . . ."

The parties have stipulated that if there had been no reorganization, Old Aetna would have been entitled to the loss carryback New Aetna seeks here. Stipulation of Facts ¶ 38.

24/
Even under the government's view there may be incidental or de minimis shifts in proprietary interests. See Rev. Rul. 74-36, 1974 Int. Rev. Bull. No. 4, at 7; Rev. Rul. 66-284, 1966-2 Cum. Bull. 115; Comment, (F) Reorganizations and Proposed Alternate Routes for Post-Reorganization Net Operating Loss Carrybacks, 66 Mich. L. Rev. 498, 498-499 n.5 (1968). The difference between the parties is that the IRS would read these precedents as limited to situations such as presented in the revenue rulings cited above--a clean-up of fractional shares; appraisal and satisfaction of the interests of shareholders owning less than one per cent of the total shares who dissented from the decision to reincorporate in another state. Although the plaintiff would read the requirement to be that there can be no economically significant shifts in proprietary interest, it claims that none have occurred here.

in proprietary interest between Old and New Aetna as a result of the reorganization. See, e.g., Hyman H. Berghash, 43 T.C. 743, 752 (1965), aff'd, 361 F.2d 257 (2d Cir. 1966). The thru[illegible] of the government's argument (leaving aside for the moment some of its technicalities) is as follows: before the reorganization, Aetna Life owned 61.61 per cent of Old Aetna; after the reorganization, the proprietary interest had shifted so that Aetna Life owned 100 per cent. Such a shift, the government contends, precludes finding that "a mere change in identity, form, or place of organization" has taken place.

A.

The plaintiff has two responses to this position. The first is that the transaction undertaken is separable into two parts. In the first part, the argument runs, the interests of the minority shareholders were "redeemed"; in the second part (after the "redemption"), there was a reorganization between Old and New Aetna in which there was an absolute identity of proprietary interests before and after the transaction (i.e., at both times Aetna Life owned all of Old and New Aetna). New Aetna contends that the second part should therefore be held to be an F reorganization.

The plaintiff's first response is drawn mainly from Reef Corp. v. Commissioner, 368 F.2d 125 (5th Cir. 1966), cert. denied, [illegible] U.S. 1018 (1967). It is sufficient for purposes here to state the facts as distilled by the court in Reef at 134:

> "First, the holders of 48% of the stock in Reef Fields had their stockholdings completely redeemed. Second, new Reef was formed and the [remaining] assets of Reef Fields were transferred to new Reef [now wholly owned by the former owners of the other 52% of stock in Reef]."

The court held that the redemption of the stock of the shareholders owning 48 per cent was "functionally unrelated" to th liquidation and reincorporation into new Reef. On that analysis the court held there was an F reorganization, since there was 100 per cent identity of ownership between the transferor and transferee and only one operating corporation was involved (the newly created shell). In addition the cour found inapplicable because of the "complete revision of the Code in 1954," 368 F.2d at 134, 137, the holding of the Supreme Court that the predecessor of § 368(a)(1)(F) did not apply where there was a shift in proprietary interest. See Helvering v. Southwest Consol. Corp., 315 U.S. 194, 202-203 (1942). Since the court found the redemption aspect of the Reef transaction irrelevant,[24A] it concluded that "[t]he only characteristics of a corporate reorganization [present in this case] are the changes in name and state of incorporation Those are primarily the characteristics of an (F) . . . reorganization. . . ." 368 F.2d at 136. Invoking the step-transaction doctrine to ignore the shift in proprietary interest which excluded the 48 per cent group in order to treat the rest of the transaction as an F reorganization may be a tenable view, but I do not share it. Neither did Circuit

24A/ Unlike Reef, where its assets were paid out to minority shareholders in redemption of their shares, 368 F.2d at 128, no assets of Old Aetna were used to redeem the shares of its minority shareholders.

Judge Griffen B. Bell whose sole difference in dissent (he also wrote the majority opinion for the court) was to this ruling. 368 F.2d at 138.

I am of the opinion that the elimination of Old Aetna's minority shareholders should not be ignored. First, there seems to be no support for the proposition that the 1954 Code revisions implicitly overruled Helvering v. Southwest Consol. Corp., 315 U.S. 194 (1942). See United States v. American Inst. of Mkt'g Sys., Inc., 345 F. Supp. 610, 612 (E.D. Mo. 1972); cf. Commissioner v. National Alfalfa Dehydrating & Milling Co., 417 U.S. 134, 152 (1974) (citation to Southwest Consol. Corp.'s analysis of a different reorganization provision); Comment, Section 368(a)(1)(F) and Loss Carrybacks in Corporate Reorganizations, 117 U. Pa. L. Rev. 764, 767-772 (1969).

Southwest Consol. Corp. would not have been controlling precedent if there had been a change in the statute. Cf. Maxwell Hardware Co. v. Commissioner, 343 F.2d 713, 716 (9th Cir. 1965). However, that was not the case with § 368(a)(1)(F).

There is as little guidance from the regulations on F reorganizations as there are cases on point. However, the legislative history of the § 368(b) exemption of F reorganizations from the exclusion of loss carryback benefits is illuminating:

> "Generally, section 381 was designed to permit certain reorganized corporations to inherit some tax attributes of their predecessors. When

section 381 was first introduced, the House version contained no reference to (F) and indeed did not allow carrybacks in any transaction covered by section 381.[47] During the Senate hearings on section 381, a plea was made for the inclusion of a carryback provision which would operate when a corporation had merely changed its identity, form, or place of organization.[48] This plea, which eventually resulted in the appearance of (F) together with a limited carryback provision in section 381(b), was precipitated by the case of a New York corporation. Having operated profitably for years, this corporation reincorporated in New Jersey, changing only its place of organization, and thereafter suffered a financial setback which eliminated its working capital. The corporation was thrown into bankruptcy when the IRS ruled that since the New Jersey corporation was not the same as the New York corporation, the loss could not be carried back to pre-reorganization years. In the Senate hearings, the proponents of a carryback pointed out that had a carryback been available, the New Jersey corporation could have replenished its working capital by means of a tax refund on prior tax years."

47. See H.R. Rep. No. 1337, 83d Cong., 2d Sess. A135 (1954). In the Senate, March 23 (legislative day March 1), 1954.
48. See Hearings on H.R. 8300 Before the Senate Comm. on Finance, 83d Cong., 2d Sess. pt. 3, 1531-70 (Report on H.R. 8300 by Section on Taxation--New York State Bar Association, Albany, N.Y.) (1954).

Comment, supra note 24, at 506-507 (certain footnotes omitted).

If the plea which led to the inclusion of an F type of reorganization in § 381 exemplifies the rationale for exempting it from an exclusion against loss carrybacks it seems clear that Congress intended carrybacks to be allowed across reorganization lines only where changes of merely formal

consequences had occurred.[25/] Insofar as rules can be stated, the language defining an F reorganization seems adequate. The intent of Congress seems entirely consistent with the Supreme Court's analysis that where there are shifts in proprietary interests a transaction can "hardly" be an F reorganization. See Helvering v. Southwest Consol. Corp., 315 U.S. 194, 202-203 (1942). Since an F reorganization is limited by the terms of the statute to effecting only a boundaried range of corporate changes, it would seem more likely that all of the changes actually effected should be examined to determine whether the limits of § 368(a)(1)(F) had been exceeded. Second, there is some indication that the Second Circuit rejects this portion of the Reef analysis. In Commissioner v. Berghash, 361 F.2d 257, 259-260 (2d Cir. 1966), the court upheld without substantial discussion a Tax Court decision refusing to find an F reorganization where a drug store owner, in a transaction similar to that in Reef, redeemed half of his interest in his company and allowed another to buy in to the extent of a 50 per cent share. The Tax Court had relied on Helvering v. Southwest Consol. Corp., 315 U.S. 194 (1942), and Joseph C. Gallagher, 39 T.C. 144 (1962), inter alia, in finding that a significant shift in proprietary interest precluded treatment as an F reorganization. It does

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25/ See Comment, supra note 24, at 510 & n.64; Comment, Section 368(a)(1)(F) and Loss Carrybacks in Corporate Reorganizations, 117 U. Pa. L. Rev. 764, 776 (1969); Tiger, Subsidiary Mergers and (F) Reorganizations, N.Y.U. 28th Inst. on Fed. Tax. 231, 264 (1970).

not follow that because a "redemption is not a characteristic of a reorganization," Reef, 368 F.2d at 168, it cannot effect a change in proprietary interest. See Hyman H. Berghash, 43 T.C. 743, 752-754 (1965), aff'd, 361 F.2d 257 (2d Cir. 1966).[26] From this affirmance of Berghash the Tax Court has concluded that the Second Circuit does not accept that portion of Reef which rejected post-1954 reliance on Southwest Consol. Corp. See Estate of Henry P. Lammerts, 54 T.C. 420, 436 (1970), aff'd in part and remanded, 456 F.2d 681 (2d Cir. 1972). I believe that this is a salutary conclusion and follow it here.

The other basis of New Aetna's theory of separable transactions is Rev. Rul. 61-156, 1961-2 Cum. Bull. 62. In the transaction there considered, a corporation (X) adopted a plan of complete liquidation then sold all its assets to a new corporation (Y) formed by the management of X. The purchasing corporation paid X 45 per cent of its stock plus notes and cash; these considerations were distributed to X's shareholders pursuant to the plan of liquidation. Y continued X's business without interruption and sold the remaining 55 per cent of its stock through a public offering. Y and the shareholders of X sought to have these transactions limited to a sale of corporate assets followed by a complete liquidation.

26/ It might be argued that Berghash does not undermine Reef because in the Second Circuit case a 50 per cent interest was transferred and a new owner entered. However, in Berghash the Second Circuit specifically approved the Tax Court's use of Gallagher, 361 F.2d at 260. In Gallagher the extent of the shift in proprietary interest was well below 50 per cent.

Because this characterization of the transaction would result in minimal tax proceed., the IRS sought to rule that the X-Y transaction was an F reorganization followed by an unrelated distribution of dividends. In the particular circumstances presented by the X-Y transaction, however, there was an apparent obstacle to finding an F reorganization: the plan included a 55 per cent shift in proprietary interest by virtue of the public issue of Y stock. The IRS solved the problem much as did the Fifth Circuit in Reef:

> "The issuance of stock to new investors can be disregarded as being a separate transaction, since even without it the dominant purpose--to withdraw corporate earnings while continuing the equity interest in substantial part in a business enterprise conducted in corporate form--was fully achieved. The issuance of stock to new investors was not needed to implement the dominant purpose and, therefore, the rest of the transaction was not fruitless without it and so dependent on it."

1961-2 Cum. Bull. at 63.

Perhaps the key to understanding both Reef and Rev. Rul. 61-156 is to realize that they were both efforts to frustrate the "liquidation-reincorporation" stratagems with which the court and the IRS were faced. Such tax avoidance plans subvert the tax laws and have created serious problems; courts and the IRS have been willing to hang decisions rejecting such stratagems in an acrobatic fashion upon any sections of the Code that seem convenient. See generally B. Bittker & J. Eustice, supra note 6, ¶ 14.54. Such rulings may solve the immediate problem, but they are quite likely to establish law

that will complicate other cases. See, e.g., Comment, supra note 25, at 779-780. The attempt to reconcile positions taken by the Commissioner or the Tax Court where tax consequences of a different kind were at stake is unrewarding, and the precedent value of those cases here is slight. However, the Ninth Circuit, for one, has shown itself willing to accept these consequences:

> "We do not see how the definitive principles of an 'F' reorganization can change from one case to another, from one context to another, dependent upon which position the Commissioner of Internal Revenue prefers. While the factual situation which gives rise to a determination in a given case will invariably differ, the standards by which the determination is to be made cannot. An 'F' reorganization is just that, and tax consequences flow from that determination, not vice versa."

Estate of Stauffer v. Commissioner, 403 F.2d 611, 619 (9th Cir. 1968). I am not so sanguine about adopting the ramifications of principles such as those established in Stauffer, Reef, Davant 27/ and Rev. Rul. 61-156. Such principles strain

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27/ 366 F.2d 874 (5th Cir. 1966), cert. denied, 386 U.S. 1022 (1967).

The use of § 368(a)(1)(F) was one of the IRS' prime weapons against the "liquidation-reincorporation" problem exemplified by the X-Y transaction in Rev. Rul. 61-156 during the early 1960's. See, e.g., Davant v. Commissioner, supra; Comment, supra note 24, at 503-504 n.34; Comment, supra note 25, at 772-776. The Commissioner has announced that Stauffer will not be followed. Rev. Rul. 69-185, 1969-1 Cum. Bull. 108.

An excellent discussion of the F reorganization and the Stauffer, Reef, and Davant cases is found in Pugh, The F Reorganization: Reveille for a Sleeping Giant, 24 Tax L. Rev. 437 (1969); see also Tiger, Subsidiary Mergers and (F) Reorganizations, N.Y.U. 28th Inst. on Fed. Tax. 231, 263 (1970).

to isolate each element of a transaction (using the "step-transaction" doctrine), whereas the normal rule is to view each transaction as a whole composed of interrelated steps. See, e.g., Spinoza, Inc. v. United States, 375 F. Supp. 439, 443-444 (S.D. Tex. 1974).

In the case at bar there is no tax avoidance scheme to be rejected. Indeed, the Aetnas' transaction was a means to an end structured as it was for the purpose of complying with § 815(f)(3)(B). See B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders ¶ 14.51, at 14-102 (3d abr. ed. 1971); Mintz & Plumb, Step Transactions in Corporate Reorganizations, N.Y.U. 12th Inst. on Fed. Tax. 247, 252-253 (1954). Each separate step had no value for its own sake. Thus I decline to apply the step-transaction logic of Reef and Rev. Rul. 61-156 to the distinguishable problem presented here. Instead, I turn to the question whether the ouster of the Old Aetna minority shareholders precludes this transaction, considered as a whole, from being an F reorganization.

B.

In Helvering v. Southwest Consol. Corp., 315 U.S. 194, 202-203 (1942), the Supreme Court said: "a transaction which shifts the ownership of the proprietary interest in a corporation is hardly 'a mere change in identity, form, or place of organization' . . . ." Courts have generally applied the Southwest Consol. Corp. standard to decide whether characterization as an F reorganization was appropriate in many subseque

cases with reorganizations involving the entrance of new shareholders. See, e.g., Hyman H. Berghash, 43 T.C. 743 (1965), aff'd, 361 F.2d 257 (2d Cir. 1966). But in this case there has not been an influx of new shareholders, only an ouster of old ones. The plaintiff contends that this distinction is significant enough to make analogies to post-Southwest Consol. Corp. cases in which new shareholders have been introduced inapt. Of course, the fact that no new shareholders entered in this case should not, without more, guarantee characterization as an F reorganization. And neither should it make inapplicable the analysis in Southwest Consol. Corp. itself. The language of the Court is broad enough to exclude an F where there are shifts in degree of ownership vel non, and the Court did not evidence any intent to qualify it.

There is a basic distinction between the view of the Supreme Court and that stated by the court in Reef, 368 F.2d at 136: "Where there is no substantial change in the corporate operation, (F) should be applied. . . ." There is a difference between continuity in the operation of a business and continuity of interest in that business. The Supreme Court emphasized that there were more than formal changes, not operational continuity. The difference is conceptual. A "mere change in identity, form, or place of organization" has no reference to any of the economic realities upon which taxes are based. It is a plausible view that unless the changes in the taxpayer corporation are of more than de minimis economic reality, it ought to be allowed to carry back losses to a

prior year. It is not enough to say that the carryback of losses (and recapture of proper taxes previously paid) "should be allowed because for all practical purposes the new corporation was the same entity as the old one and . . . the same taxpayer." New Colonial Ice Co. v. Helvering, 292 U.S. 435, 441 (1934).

The issue here is to what extent the Supreme Court's language in Southwest Consol. Corp. precludes shifts of interest among shareholders in an F reorganization. There have been no cases which have attempted to answer this question in a squarely analogous situation. New Aetna cites several cases, but none provide any substantial aid in resolving the question presented here.[28] In Gordon v. Commissioner,

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28/ San Joaquin Fruit & Investment Co., 28 B.T.A. 395 (1933), rev'd on other grounds, 77 F.2d 723 (9th Cir. 1935), rev'd, 297 U.S. 496 (1936), was decided in the Tax Court nine years before the applicable rule was announced in Southwest Consol. Corp. Nutil v. United States, 23 Am. Fed. Tax R.2d 69-486 (C. D. Cal. Sept. 16, 1968), and Breech v. United States, 23 Am. Fed. Tax R.2d 69-489 (C.D. Cal. Sept. 19, 1968), aff'd on unrelated ground, 439 F.2d 409 (9th Cir. 1971), were in relevant part related refund suits by shareholders of the same company. The transaction there at issue had several features that distinguish it from the transaction at bar: it was a liquidation-reincorporation scheme in which new shareholders entered and, as here, the relative interests of the old shareholders shifted. The court, without discussion of Southwest Consol. Corp. or the effect of the shift in relative interests, found both a D and an F reorganization. The opinions of the court make it clear that its holding was predicated on a desire to avoid giving effect to the plaintiffs' "contrivance to bail out corporate earnings at capital gains tax rates." Nutil v. United States, 23 Am. Fed. Tax R.2d 69-486, 69-489 (C.D. Cal. Sept. 16, 1968). However, the court found no legitimate business purpose for the transaction there undertaken, and such a purpose is normally a prerequisite to characterization as a reorganization. See, e.g., Helvering v. Gregory, 69 F.2d 809 (2d Cir. 1934), aff'd, 293 U.S. 465 (1935); Treas. Reg. § 1.368-1(b) to -1(c) (1955). Thus these decisions are distinguishable from this case. To the extent that they are not, I decline to follow them.

424 F.2d 378 (2d Cir.), cert. denied, 400 U.S. 848 (1970), the court observed at 384:

> "Although a number of cases have pointed to a complete identity of shareholders before and after the transaction as evidence that the corporation had undergone a mere change in form, see, e.g., Associated Machine v. Commissioner of Internal Revenue, 403 F.2d 622, 625 (9 Cir. 1968); Estate of Stauffer v. Commissioner of Internal Revenue, 403 F.2d 611, 618 (9 Cir. 1968); Davant v. Commissioner of Internal Revenue, 366 F.2d 874, 884 (5 Cir. 1966), cert. denied, 386 U.S. 1022, 87 S. Ct. 1370, 18 L.Ed.2d 460 (1967), it is not clear thus far whether such an identity is an indispensable condition to the invocation of Section 368(a)(1)(F)."

In determining whether the changes effected by a transaction are so insubstantial as to fall within the exception to § 381(b)(3), Congress had directed that the economic realities, not mere forms of reorganization, must control. See H.R. Rep. No. 1337, 83d Cong., 2d Sess. (1954), 1954-3 U.S. Code, Cong. & Admin. News 4025, 4066-4067; S. Rep. 1622, 83d Cong., 2d Sess. (1954), 1954-3 U.S. Code, Cong. & Admin. News 4629, 4683-4684; Comment, supra note 24, at 513. In this case the economic realities seem quite plain. The minority shareholders were eliminated and Aetna Life, which previously had owned only 61.61 per cent of Old Aetna, became the sole owner of its successor, New Aetna.[29/] Ultimately,

29/ The parties have devoted a great deal of space to arguing how this change should be measured. By virtue of the stapled trust pre-merger Aetna Life shareholders received approximately 80 per cent of the beneficial interest in New Aetna, and former Aetna Casualty shareholders holding 38.39 percent of its shares received a beneficial interest of only about 20 per cent--a dilution of more than 40 per cent. On New Aetna's method of

it is the shareholders of a corporation who own it, and a basic distinction must be made between that ownership interest in the corporation and "a mere change in identity, form, or place of organization" which will satisfy an F corporate reorganization. In this case the shift in interests resulted in one group of shareholders (38.39 per cent) being ousted. The plaintiff argues that their involvement continued by virtue of their receipt of shares in Aetna Life, which became the owner of New Aetna. This fact should not be singled out as controlling. The Supreme Court spoke of "shifts" in proprietary interests, and there is no reason to believe that a complete ouster should not be viewed as a significant shift. Through the merger the minority shareholders of Aetna Casualty obtained 5,106,187 shares of Aetna Life. Non-exchanging Aetna Life shareholders held 20,000,000 shares. (Exh. H to Stipulation of Facts, at 6). Giving effect to the stapled trust the equity of a share in Aetna Life increased from $54.07 before the merger to $65.95 after it; Aetna Casualty stock equity went from $48.76 to $50.12. Comment, supra note 25, at 779; Exh. H to Stipulation of Facts, at 11. Practical changes in the control of the business resulted from the reorganization

29/ cont'd

calculation it is possible to conclude that there has been only an 8.98 per cent shift in proprietary interest. This is a debate that I decline to enter: the economic reality of the change in proprietary interest, however measured, is sufficient to control the tax significance of the transaction. There is no logical basis for holding that because 80 per cent control is needed to qualify for non-taxability of an exchange (§ 368 (c)) any change in proprietary interest of less than 20 per cent is de minimis for an F.

These realities cannot be ignored; there has been a substantial change in the proprietary interests of the Aetna Casualty and Surety Co. shareholders.[30] The scope of that change is beyond that which Congress had in mind in enacting the F exemption from the carryback exclusion of § 381(b)(3). In view of all these factors, it cannot be said that the Aetnas' transaction falls within the definition of an F as "a mere change in identity, form, or place of organization."[31]

V.

Because the Aetnas' transaction was a reorganization, but not a B or an F reorganization, within the meaning of § 368(a)(1), § 381(b)(3) prohibits New Aetna from offsetting its 1964 and 1965 losses against Old Aetna's 1963 income. Therefore, New Aetna's motion for summary judgment is denied; the government's motion for summary judgment is granted. It is

SO ORDERED.

30/ When the bank trustee selected by Aetna Life became the legal owner of all of the shares of New Aetna, the former shareholders of Old Aetna were merely cestuis que trustent for whose benefit the shares were held. Thus not only was their interest proportionately reduced, the nature of it changed to less than full ownership.

31/ Cf. Comment, *supra* note 25, at 779.

Dated at Hartford, Connecticut, this 15th day of October, 1975.

M. Joseph Blumenfeld

M. Joseph Blumenfeld
United States District Judge

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U.S. DISTRICT COURT
HARTFORD, CONN.

UNITED STATES DISTRICT COURT

DISTRICT OF CONNECTICUT

THE AETNA CASUALTY AND SURETY COMPANY, for itself and as successor by merger to The Aetna Casualty and Surety Company	:	
v	:	CIVIL NO. H-13[illegible]
UNITED STATES OF AMERICA	:	

JUDGMENT

The above-entitled action came on for consideration by the Court by the Honorable M. Joseph Blumenfeld, United States District Judge, of the cross-motions of the parties for Summary Judgment;

And the parties having stipulated to most (and disagree as to none) of the material facts;

And after a hearing by the Court on said cross-motions for summary judgment, the Court filed its Memorandum of Decision denying the Plaintiff's Motion for Summary Judgment and granting the Defendant's Motion for Summary Judgment;

It is accordingly ORDERED and ADJUDGED that Summary Judgment enter and hereby does enter for the Defendant and the Plaintiff's Complaint be, and is hereby, dismissed.

Dated at Hartford, Connecticut, this 10th day of December, 1975.

SYLVESTER A. MARKOWSKI
Clerk, United States District Court

By: [signature]

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF CONNECTICUT

THE AETNA CASUALTY AND SURETY COMPANY, Plaintiff,	)	
v.	)	CIVIL NO. H-131
UNITED STATES OF AMERICA, Defendant.	)	

AMENDED NOTICE OF APPEAL

Notice is hereby given that The Aetna Casualty and Surety Company, plaintiff above-named, hereby amends its Notice of Appeal dated December 12, 1975, to read as follows:

Notice is hereby given that The Aetna Casualty and Surety Company, plaintiff above-named, hereby appeals to the United States Court of Appeals for the Second Circuit from the judgment entered in this action on the 10th day of December, 1975.

DATED: January 28, 1976

THE AETNA CASUALTY AND SURETY COMPANY, Plaintiff

By ______________________
J. Danford Anthony, Jr.
Of Day, Berry & Howard
Its Attorneys

We hereby certify that a copy of the foregoing Amended Notice of Appeal has been mailed this 28th day of January, 1976, postage prepaid, to counsel for the defendant, addressed as follows: Scott P. Crampton, Esq., Assistant Attorney General, and Robert N. Greco, Esq., Tax Division, United States Department of Justice, Washington, D.C. 20530.

____
J. Danford Anthony, Jr.
Of Day, Berry & Howard
One Constitution Plaza
Hartford, CT 06103